Financial Reporting Committee

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Chairman
International Accounting Standards Board
30 Cannon Street
London
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Dear Hans

ED/2015/3 – Conceptual Framework for Financial Reporting

We welcome the opportunity to comment on the above proposals.

Who we are

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the UK FTSE 100 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. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.

Summary of our views

Stewardship

We believe that the provision of stewardship information should be a primary objective of general purpose financial reporting in addition to providing information to support resource allocation ('buy/sell/hold') decisions. We consider that putting a greater emphasis on stewardship would have two principal effects on accounting standards:

(a) accounting would more often reflect how an entity conducts its business activities rather than theoretical market values; and

(b) accounting would be more likely to support long-term investment (a key focus of the G20 when considering accounting standards).

Prudence

We believe that, as currently drafted, prudence cannot be reconciled with neutrality. We disagree with the Board's rejection of the notion of "asymmetric prudence", which we consider to be fundamental to current accounting and which is so clearly embedded in many existing standards.

Relevance and reliability

We believe that an asset or a liability should be recognised if

(a) it is probable (i.e. more likely than not) that an inflow or outflow of economic benefits will result ; and

(b) the amount of those economic benefits can be measured reliably.

We agree with the Board that measurement uncertainty may affect the recognition of an asset or a liability, but for different reasons. We do not consider that measurement uncertainty affects the relevance of financial information. Rather, we believe that measurement uncertainty affects the reliability of information. Information may well be relevant but, if it cannot be measured reliably, it is unlikely to be useful (and indeed may be misleading) to users of financial statements. As a consequence, we believe that 'reliability' should be included as one of the enhancing characteristics of faithful representation, separate from 'verifiability' since there are important differences between the consequences of the two concepts.

Reporting entities

We consider that it is inappropriate for the Board to assert that "in general consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements" (paragraph 3.23). We believe that the usefulness or otherwise of unconsolidated financial statements relative to consolidated financial statements will depend on the user's interests. Moreover, in some countries, such as the UK, there is a legal requirement for a parent to prepare and file unconsolidated financial statements.

Financial performance

We continue to believe that most preparers and investors view financial performance as the result of transactions and cash flows in a period, rather than as a difference between two balance sheets. We believe that this perspective is key in assessing how comprehensive income should be classified between profit and loss and other (OCI). While we acknowledge the Board's reluctance to delay the finalisation of the Conceptual Framework to resolve this classification, we would suggest that the Board addresses concepts of financial performance as part of its project on financial statement presentation.

Measurement basis

We believe that the principal considerations in selecting a measurement basis should be relevance and reliability. We also consider that a rebuttable presumption that assets and liabilities should be measured at historical cost unless another basis provides more relevant information would be helpful in explaining the measurement bases adopted in individual standards.

Consequential impact

We do not believe it tenable for the Board to ignore any major inconsistencies between existing standards and the revised Conceptual Framework that could lead to a significantly different accounting result. We therefore urge the Board to address as a matter of urgency the main inconsistencies that it has identified.

Length

As currently drafted, the Conceptual Framework is significantly longer than previous versions. We do not believe that the fundamental principles have become significantly more complicated over the years and find it difficult to understand why it now takes so many more words for the Board to explain those principles.

Feedback

Please feel free to contact me through the 100 Group's website, www.the100group.co.uk, should you wish to discuss our comments.

Yours sincerely

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Chairman
Financial Reporting Committee
The 100 Group of Finance Directors

Responses to specific questions

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 a specific 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 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 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?

Why or why not?

In our response to the 2010 Discussion Paper we agreed with the Board that fundamental reconsideration the chapters of the Conceptual Framework dealing with the objective of general purpose financial reporting and the qualitative characteristics of useful financial information was not warranted, but we asked 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.

We appreciate the fact that the Board has gone some way towards addressing these issues in its revised proposals.

Question 1 (a) - Stewardship

Whilst we welcome the Board's intention to give greater prominence to stewardship in the discussion of the objective of financial reporting, we believe that the Board should go further and actually identify the provision of information about management's stewardship as an objective of general purpose financial reporting.

In paragraph 1.2, the Board expresses its view (unchanged from the 2010 Conceptual Framework) 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. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit". In other words, the Board sees the sole objective of financial reporting to be to inform resource allocation ('buy/sell/hold') decisions.

In paragraph BC1.10, the Board explains that it has rejected the idea of identifying the provision of stewardship information as an objective of general purpose financial reporting

because such information is part of the information used to make resource allocation decisions and to introduce an additional primary objective of financial reporting could be confusing. Whilst we agree that stewardship information is relevant to resource allocation decisions, we believe that it has wider relevance to investors who invest for the long term. Such investors find stewardship information useful in assessing management's performance and, where necessary, in seeking to influence management's actions or to replace management that is not delivering adequate returns. By enabling investors to hold management to account, stewardship information is a critical support for the exercise of effective corporate governance.

We therefore believe that the provision of stewardship information should be a primary objective of general purpose financial reporting in addition to providing information to support resource allocation decisions.

We have been asked in the past how we think putting a greater emphasis on stewardship in the Conceptual Framework would affect accounting standards. We believe that there would be two principal effects:

(c) accounting would more often reflect how an entity conducts its business activities rather than theoretical market values (that by the Board's own admission are not always relevant to users); and

(d) accounting would be more likely to support long-term investment (a key focus of the G20 when considering accounting standards) than if the objective was focused solely on buy/hold/sell decisions (see also our answer to Question 17).

Question 1 (b) - Prudence

We welcome the reintroduction of specific reference to prudence in the Conceptual Framework but we consider that whilst there is considerable discussion of prudence in the Basis of Conclusions the discussion in the Conceptual Framework itself is somewhat lacking in substance. Paragraph 2.18 begins with the assertion that "Neutrality is supported by the exercise of prudence" and whilst it goes on to explain and illustrate what is meant by prudence it does not does not explain how prudence is compatible with neutrality as a characteristic of faithful representation.

We suggest that the Board revisits the wording of paragraph 2.18 with a view to including a more convincing explanation of how neutrality is supported by the exercise of prudence.

In the Exposure Draft, the Board defines prudence as "the exercise of caution when making judgements under conditions of uncertainty" (which it terms 'cautious prudence'). In the Basis of Conclusions, the Board considers (and rejects) the notion that prudence also requires the more timely recognition of liabilities and losses than assets and gains (which it terms 'asymmetric prudence'). We believe that the notion of asymmetric prudence is fundamental to present day accounting as can be observed from the fact that it underlies many existing standards, for example:

(a) non-financial assets are written down if their recoverable amount falls below their carrying amount but are not written up if the reverse applies;

(b) provision is made for onerous contracts but an asset is not generally recognised for favourable contracts (see also our answer to Question 5); and

(c) contingent liabilities are disclosed unless the possibility of an outflow in settlement is remote but contingent assets are disclosed only if an inflow of benefits is probable.

Based on the discussion in paragraphs BC2.12-2.14, the Board considers that it is not necessary to identify the notion of asymmetric prudence in the Conceptual Framework because asymmetric prudence can be achieved by the selection of neutral accounting

policies. We do not consider this to be a cogent argument because the accounting policies that are selected by entities are (for the most part) prescribed by accounting standards. If the Conceptual Framework does not encompass the notion of asymmetric prudence, neither will the accounting standards and, in turn, the accounting policies that are based upon it.

We sense that the Board is opposed to including the notion of asymmetric prudence in the Conceptual Framework because it is concerned that it is incompatible with measurement at current values (which inevitably leads to the recognition of unrealised gains in financial statements). In our answer to Question 9, we suggest that the Board starts from a default position whereby assets and liabilities are measured at historical cost except in circumstances where another measurement basis provides more relevant information. Consistent with this approach, we would suggest that the Conceptual Framework should include a rebuttable presumption of asymmetric prudence, i.e. that liabilities and losses should be recognised earlier than assets and gains. Where the Board seeks to move away from measurement at historical cost it would also need to consider whether the presumption of asymmetric prudence should be rebutted in applying current value measurement, i.e. whether the recognition of unrealised measurement gains provides more relevant information.

We recognise that recognition of unrealised remeasurement gains is a hotly debated subject and would be likely to remain so even if a rebuttable presumption of asymmetric prudence was to be included in the Conceptual Framework. We believe, however, that much of the heat could be taken out of the debate if the Board were to define OCI such that remeasurement gains and losses would not be reflected in profit or loss (we expand on this suggestion in our answer to Question 13).

Question 1 (c) - Substance over form

We welcome the proposal to include an explicit reference to substance over form in the Conceptual Framework itself (rather than only in the Basis for Conclusions as at present). We agree that consideration of substance over form relates to faithful representation because accounting for something in accordance with its legal form (even with appropriate disclosures) cannot result in a faithful representation if the economic substance of the item is different.

Relevance and faithful representation

Question 1(d) – Measurement uncertainty

We do not agree with the Board that measurement uncertainty affects the relevance of financial information. Rather, we believe that measurement uncertainty affects the reliability of information. The Oxford English Dictionary defines 'relevant' as "bearing upon, pertinent to, the matter in hand" and 'reliable' as "that may be relied upon, of sound and consistent character or quality". Based on these definitions, information may well be relevant but if it cannot be measured reliably it is unlikely to be useful (indeed may be misleading) to users of financial statements.

Question 1(e) – Fundamental characteristics

When we commented on the proposals that led to the 2010 Conceptual Framework, we said that we did not support the replacement of the concept of 'reliability' with that of 'faithful representation'.

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.

Some consider that it is unnecessary to reinstate 'reliability' because 'verifiability' is included as an enhancing characteristic and the terms have essentially the same meaning. The Oxford English Dictionary defines 'verify' as "to establish the truth of, examine for this purpose, support (statement) by proofs". We therefore believe that reliability and verifiability have different meanings. Perhaps the best example we can give is a situation where an impairment test is being conducted based on cash flow forecasts extracted from the reporting entity's most recent five-year plan. Whilst the cash flows are verifiable (because they can be agreed to the five-year plan) they may not be reliable (because the entity's management may have a record of producing unrealistic cash flow forecasts).

Summarising our answers to Question 1(d) and 1(e), we believe that measurement uncertainty should not be considered in the context of relevance but that it should be recognised by the addition of 'reliability' to the enhancing characteristics that augment the concept of faithful representation.

Question 2 – Description and boundary of a reporting entity

Do you agree with:

(a) the proposed description of a reporting entity in paragraphs 3.11-2.12; and

(b) the discussion of the boundary of a reporting entity in paragraphs 3.13-3.25?

Why or why not?

We generally agree with the description of a reporting entity and the discussion of the boundary of a reporting entity.

We do not agree, however, with the assertion made in paragraph 3.23 that "in general, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements". General purpose financial statements provide information to a wide range of users and the usefulness or otherwise of unconsolidated financial statements relative to consolidated financial statements will depend on the user's interests. For example, a user who is interested in the parent company's ability to service debt, support a financial guarantee or to pay dividends may well find the parent's unconsolidated financial statements more useful than the consolidated financial statements.

We believe that it is inappropriate for the Board effectively to undermine the status of unconsolidated financial statements since IFRS, or IFRS-based accounting standards, have been adopted in countries, such as the UK, where there is a legal requirement for a parent to prepare and file unconsolidated financial statements. We therefore recommend that paragraph 3.23 should be deleted.

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?

We broadly agree with the proposed definitions of the elements of financial statements.

Asset and liability

As shown in the table below, the principal difference between the existing and proposed definitions of an asset and a liability is the removal from the definitions of reference to the likelihood of future benefit flows.

Existing definition	**Proposed definition**
Asset An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow. [CF paragraph 4.4]	Asset An asset is a present economic resource controlled by the entity as a result of past events. [ED paragraph 4.5]
Liability A liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. (CF paragraph 4.4]	Liability A liability is a present obligation of the entity to transfer an economic resource as a result of past events. [ED paragraph 4.24]

We welcome this change since it separates from the definition of an asset and a liability any reference to the criteria for their recognition in financial statements. We have always struggled with paragraph 4.5 of the existing Conceptual Framework which states that the current definitions of an asset and a liability "do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet" because in our view the existing definitions do stray into the criteria for recognition. We consider the proposed recognition criteria in our answer to Question 6.

We do not believe that it is necessary to include the word 'present' in the definition of an asset because we find it difficult to conceive of an economic resource that is controlled by the entity being anything but present.

Economic resource

Whilst examples of rights that constitute economic benefits are provided in paragraph 4.8, the term 'right' is not actually defined in the Conceptual Framework. We believe that the Board's intentions would be clearer if the term 'right' were defined, e.g. dictionary.com defines a 'right' as "a just claim or title, whether legal, prescriptive or moral".

Existing definition	**Proposed definition**
Economic benefit The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity [CF paragraph 4.8]	Economic resource An economic resource is a right that has the potential to produce economic benefits [ED paragraph 4.6]

Paragraph 4.25 states "If one party has an obligation to transfer an economic resource (a liability), it follows that another party (or parties) has a right to receive that economic resource (an asset)". Whilst this will be the case over time, it may not necessarily be the case at the present time because it may not be sufficiently clear which entity (or entities) will benefit from the settlement or fulfilment of the obligation, i.e. that a right constituting economic benefits exists. Whilst there may be theoretical symmetry of existence of an asset and a liability, there may well be asymmetry of recognition of the asset and liability for accounting purposes. We therefore believe that the discussion of theoretical symmetry is unnecessary and potentially confusing and should be removed from the Conceptual Framework.

Equity

We agree with the definition of equity which is unchanged from the existing Conceptual Framework, i.e. the residual interest in the assets of the entity after deducting all of its liabilities.

We acknowledge the Alternative View put forward by Ms Lloyd and Mr Finnegan and agree that ideally more thought should have been given to the classification of complex financial instruments that have characteristics of both liabilities and equity. We recall, however, the Discussion Paper on that subject that was published back in 2008 and consider that if that debate had been re-opened it would have caused an unacceptable delay in issuing the revised Conceptual Framework since the issue is not one of widespread concern. We therefore support the Board in its decision not to explore any further the distinction between liabilities and equity at this stage but suggest that this should be given priority on the Board's agenda.

Income and expenses

In our response to the 2013 Discussion Paper, we observed that preparers typically have a different view of financial performance than the Board, which essentially considers financial performance to be the net change in economic resources and claims (put simply, the difference between two balance sheets). Preparers 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 recognise, however, that the difference between our view of performance and that of the Board is unlikely to be resolved in the foreseeable future. Whilst we are therefore not entirely happy with the proposed definitions of income and expenses (which are defined in terms of changes in assets and liabilities), we welcome the acknowledgement in paragraph 4.52 that financial performance may indeed be something more than changes in assets and liabilities. We suggest, however, that the final sentence of that paragraph should be amended to read "information about income and expenses is just as important as ~~the~~ information ~~provided by~~ *about* assets and liabilities".

Question 4 – Present obligation
Do you agree with the proposed definition of a present obligation and the proposed guidance to support that description? Why or why not?

We recognise that 'present obligation' is not clearly defined at present and that there is some divergence in the interpretation of the term between accounting standards. It is proposed that a present obligation to transfer an economic resource shall exist if both:

(a) the entity has no practical ability to avoid the transfer; and

(b) the obligation has arisen from past events......

With regard to the ability to avoid the transfer, we suspect that current practice is generally to take guidance from the definition of an 'obligating event' in IAS 37 which refers to "an entity having no realistic alternative to settling" an obligation. Whilst it is proposed that the phase 'no practical ability' should be used rather than 'no realistic alternative' we believe that the phrases are interchangeable. Indeed, the Oxford English Dictionary defines 'realistic' as "interested in, concerned with, or based on what is real or practical". We believe that the use of either phrase would be compatible with the notion that an obligation may be legal or constructive (which we believe is not something that could be said if the definition was based on the entity having 'no ability, even in theory' to avoid settlement).

We are broadly content with the proposed guidance on the existence of a past event with the proviso that the first sentence of paragraph 4.39 does not seem to make sense (there is perhaps the word 'and' or 'or' missing?).

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 the guidance should include.

<u>Cash flows</u>

Since one of the objectives of financial statements is to provide information that is useful to users in "assessing the prospects for future net cash inflows to the entity", we find it strange that there is no mention of cash flows as being an element of financial statements or specifically of the statement of cash flows being a statement of financial performance that should be included within financial statements.

<u>Executory contracts</u>

We struggle to understand how the accounting for executory contracts that are measured at historical cost can be supported unless the Conceptual Framework encompasses the notion of 'asymmetric prudence' (see our answer to Question 1).

Paragraph BC.4.92 states "In many cases in current practice, an asset or a liability is not recognised for an executory contract.............When historical cost measurement is applied to an executory contract, the contract is measured at zero (which has the same practical effect as not recognising the contract) unless it is onerous". Whilst this is undoubtedly the case, no explanation is given in the Conceptual Framework as to why an onerous contract should be recognised as a liability whilst a favourable contract should not be recognised as an asset. We believe that this could be justified only if the Conceptual Framework encompasses the notion of asymmetric prudence, i.e. that liabilities and losses should be recognised earlier than assets and gains.

In our answer to Question 1, we suggest that the Conceptual Framework should include a rebuttable presumption of 'asymmetric prudence'. For those executory contracts that are measured at current value (e.g. forward foreign currency contracts), the recognition of favourable contracts as an asset would be possible if the presumption of asymmetric prudence could be rebutted, i.e. it could be demonstrated that the recognition of the asset provided more relevant information.

For the avoidance of confusion between those executory contracts that are measured at historical cost and those that are measured at current value, we suggest that paragraph 4.41 should be amended slightly as follows: "The entity has an asset if the terms of the exchange are favourable *but* ~~; it~~ has a liability if the terms of the exchange are unfavourable. Whether the asset or the liability is included in the financial statements depends on both the recognition criteria (see Chapter 5) and the measurement basis adopted for the contract (see Chapter 6)~~, including, if applicable, any test for whether the contract is onerous~~."

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?

We agree that the recognition of an asset or liability should be conditional on whether such recognition provides users of financial statements with useful information. We do not, however, subscribe to the Board's view expressed in paragraph 5.10 that recognition requirements may need to vary between standards because "It is not possible to define precisely when recognition of an item that meets the definition of an element will provide useful information to the users of financial statements". We consider that the Conceptual Framework should set out recognition criteria that may be applied consistently in all standards.

We believe that an asset or a liability should be recognised if:

(c) it is probable (i.e. more likely than not) that an inflow or outflow of economic benefits will result ; and

(d) the amount of those economic benefits can be measured reliably.

We agree with the Board that measurement uncertainty may affect the recognition of an asset or a liability, but for different reasons. As explained in our answer to Question 1, we do not agree with the Board that measurement uncertainty affects the relevance of financial information. Rather, we believe that measurement uncertainty affects the reliability of information. Information may well be relevant but if it cannot be measured reliably it is unlikely to be useful (indeed may be potentially misleading) to users of financial statements.

We do not consider that uncertainty as to whether an asset or a liability exists, or is separable from goodwill, should feature in the recognition criteria in paragraph 5.13. We believe that such uncertainty should be dealt with in the definition of an asset or a liability, i.e. whether an economic resource or obligation to transfer a resource meets the definition of an asset or a liability. Recognition criteria should determine whether an asset or a liability should be recognised.

We agree that cost may be a constraint on recognition where the cost of recognition outweighs the benefits. We look forward to seeing future accounting standards that specifically permit assets or liabilities not to be recognised on cost-benefit grounds.

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?

We agree with the discussion of derecognition in that:

(a) all or part of an asset should normally be derecognised when the entity loses control of all or part of the previously recognised asset; and

(b) all or part of a liability should normally be derecognised when the entity no longer has a present obligation for all or part of a previously recognised liability.

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?

We are rather surprised that the Board has restricted the discussion to historical cost and current value (fair value or value in use/fulfilment value). We would have expected to find in the Basis of Conclusions discussion of other bases of measurement such as current cost (which is mentioned but only fleetingly in the context of historical cost), net realisable value, constant purchasing power and deprival/relief value (which are not discussed at all).

We are concerned that the Board offers no justification for the statement in paragraph 6.10 that it "would be unlikely to consider selecting current cost as a measurement basis when developing future standards" (we explore the significance of this statement in our discussion of capital maintenance concepts in our answer to Question 18).

We consider the discussion of the information provided by each of the measurement bases and their advantages and disadvantages to be rather laboured. We would suggest that Table 6.1 is retained but that the discussion of their advantages and disadvantages would be better covered in the section dealing with the factors to consider when selecting a measurement basis.

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?

As currently drafted, this section does little more than re-iterate the application of the qualitative characteristics of financial information set out in Chapter 2. We suggest that the advantages and disadvantages of the respective measurement bases should be interwoven with this discussion so as to illustrate clearly the situations in which one measurement basis is preferred over another.

Consistent with our answer to Question 1, we consider that the principal considerations in selecting a measurement basis should be relevance and reliability, i.e. does the measurement basis provide relevant information and can it be measured reliably.

Philosophically, we do not understand how a phenomenon that does not exist can be faithfully represented, e,g, the fair value of an asset based on the perspective of hypothetical market participants in a market that does not exist.

Consistent with our response to the 2013 Discussion Paper, we suggest that the Board starts from a default position whereby assets and liabilities are measured at historical cost except in circumstances where another measurement basis provides more relevant information. We believe that the Board would then find it easier to rationalise and explain the departures from the default position when developing individual standards.

Question 10 – More than one relevant measurement basis
Do you agree with the approach discussed in paragraphs 6.74 -6.77 and BC 6.68? Why or why not?

We cannot disagree with these paragraphs because without them some important accounting treatments would not be possible under IFRS, e.g. hedge accounting under IFRS 9, but we consider they provide a very good example of how the Conceptual Framework has been made to fit existing accounting standards.

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 and communication tools?

We believe that financial reporting is fundamentally an exercise in communication and therefore welcome the discussion in the Conceptual Framework of presentation and disclosure as tools of communication.

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.

<u>A missed opportunity</u>

We believe that the Conceptual Framework should provide the conceptual foundation on which accounting standards are based. Regrettably, the proposed Conceptual Framework has been made to fit existing accounting standards and this is no more clearly demonstrated than in the discussion of 'Information about financial performance' in paragraphs 7.19 - 7.27.

Whilst the Board "concluded that conceptual guidance on this issue is urgently needed" (paragraph BC7.33), it "decided that it is not feasible or appropriate to attempt to define, or precisely describe, in the Conceptual Framework when an item of income or expenses should be included in the statement of profit or loss or OCI" (paragraph BC7.36)

We agree with Messrs Cooper & Finnegan that by not developing concepts with regard to the reporting of financial performance, the Board has left itself in no better position than it is now to make standards-level decisions about the presentation of items of income and expense, what items should be included in OCI and whether and when they should subsequently be reclassified to profit or loss (recycled).

We recognise, however, that if the Board were to begin to address these issues now it would be highly unlikely that consensus could be reached within a timescale that will be acceptable given the pressure on the Board to finalise the Conceptual Framework. We therefore suggest to the Board that it should address the concepts underlying the reporting of financial performance as part of its financial statements presentation project and that the Conceptual Framework should be revised as necessary in the future to reflect the outcome of those deliberations.

What do we think?

We consider that there is no need to define financial performance in the context of comprehensive income. Comprehensive income comprises income and expenses which are themselves defined in the proposed Conceptual Framework in terms of changes in assets and liabilities.

Income	**Expenses**
Income is increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims. [ED paragraph 4.48]	Expenses are decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims. [ED paragraph 4.49]

We therefore believe that the fundamental problem to be addressed in reporting financial performance is not the definition of financial performance but how comprehensive income should be categorised. Some categories of comprehensive income (such as sales, cost of sales, interest income and expense) are widely accepted without question. What is under debate is what should be included in a sub-total within comprehensive income that encompasses items of comprehensive income that are in some way different from other items of comprehensive income. We currently call this sub-total profit or loss and the items dealt with outside profit or loss are termed OCI.

Paragraph 7.19 proposes that this distinction should be maintained "in order to communicate information about financial performance more efficiently and effectively", but offers no explanation as to how the inclusion of a sub-total achieves greater efficiency and effectiveness.

Paragraph 7.20 states:

"The purpose of the statement of profit or loss is to:

(a) depict the return that an entity has made on its economic resources during the period; and

(b) provide information that is helpful in assessing prospects for future cash flows and in assessing management's stewardship of the entity's resources."

Paragraph 7.21 goes on to assert "Hence, income and expenses included in the statement of profit or loss are the primary source of information about an entity's financial performance for the period."

Whilst we do not disagree with the sentiment of these statements, we consider that the Board has done nothing to justify them. We believe that in order to sustain these statements the Board would need to explain why profit or loss (a sub-total within comprehensive income) rather than comprehensive income should be considered to be the primary source of information about an entity's financial performance.

We believe that the solution lies not in finding a definition of profit or loss but, rather, in developing robust principles for the classification of certain items of income and expense in OCI rather than in profit or loss.

Question 13 – Reporting items of income and 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?

We consider that the proposals on the use of OCI have been retro-fitted to existing accounting standards and leave the Board in no better position that it is now to make future standards-level decisions about which items of income and expenses should be classified as OCI.

In our response to the 2013 Discussion Paper, we expressed our view that sub-totals should be presented within comprehensive income that distinguish between the effect of transactions (i.e. trading) during the period (profit or loss) and other items (OCI). We suggest that profit or loss should show the results of trading during the period whereas OCI should show the effect of remeasurements of assets and liabilities. In this scenario, OCI might include the following:

(a) currency translation differences on net investments in foreign subsidiaries;

(b) changes in the value of assets and liabilities that are measured at current value, including:

  (i) impairment of non-financial assets;

  (ii) actuarial gains and losses on defined benefit pension plans; and

  (iii) changes in the fair value of derivative financial instruments held in designated hedging relationships;

(c) the effect of changes in discount rates (but not the effect of unwinding of the discount).

We believe that such an analysis of comprehensive income between the results of trading during the period and remeasurements would improve the usefulness of financial statements as a predictor of future cash flows and as a means of assessing management's stewardship of the entity's resources.

Question 14 – Recycling
Do you agree that the Conceptual Framework should include the rebuttable presumption [that items included in other comprehensive income will be reclassified into the statement of profit or loss in some future period, if doing so will enhance the relevance of information included in the statement of profit or loss for that future period] described above? Why or why not? If you disagree, what do you propose instead and why?

We find it difficult to understand how the Board would be able to determine whether recycling will "enhance the relevance of information included in profit or loss" if there is no conceptual basis for determining what should be included in profit or loss.

We recognise, however, that the proposed recycling rules are written in such a way that they are compatible with existing accounting standards. In that context, we agree that the presumption that an item will be recycled could be rebutted if there is no clear basis for identifying the period in which recycling would enhance the relevance of information in the statement of profit or loss. We take issue, however, with the assertion in paragraph 7.27 that "If no such basis can be identified, this may indicate that the income or expenses should not

be included in other comprehensive income". For example, it is unlikely that there will be a clear basis for identifying the period in which cumulative actuarial gains and losses should be recycled to profit or loss but it does not follow that actuarial gains and losses should not be classified as OCI.

Consistent with our alternative proposal for classifying items as OCI, we believe remeasurements included in OCI should be recycled to profit or loss only when to do so would be relevant to the results of trading in the period, e.g. when a hedged item is recognised in profit or loss.

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?

We acknowledge the separate Exposure Draft that has been issued by the Board to update references to the Conceptual Framework within existing standards and the work that has been done by the Board to identify inconsistencies between the proposed Conceptual Framework and existing standards.

Whilst we recognise that the Board considers that the purpose of Conceptual Framework project is to provide a coherent basis for developing future standards and not to eliminate existing inconsistencies, we do not believe it would be tenable for the Board to ignore any major inconsistencies between existing standards and the revised Conceptual Framework that could lead to a significantly different accounting result. We therefore urge the Board to address as a matter of urgency the main inconsistencies that it has identified, i.e.

(a) the classification of certain items as liabilities or equity under IAS 32 (which will be addressed by the project that we refer to in our answer to Question 3); and

(b) the accounting for levies under IFRIC 21.

It would also help to avoid any unnecessary confusion if the Board were to address inconsistencies between the definitions and terminology used in the revised Conceptual Framework and existing standards within the scope of its separate project to update references to the Conceptual Framework.

We welcome the proposed transition period for entities of approximately 18 months between the issue of the revised Conceptual Framework and its effective date. We expect that this will allow sufficient time for those entities that have developed an accounting policy based on the existing Conceptual Framework to consider whether those policies are consistent with the revised framework and prepare for the retrospective application of any changes.

Question 16 – Business activities
Do you agree with the proposed approach to business activities? Why or why not?

We agree that the Conceptual Framework should not use the term 'business model' because that term is used with different meanings by other organisations. We strongly believe, however, that the way in which an entity conducts its activities has implications for both relevance and faithful representation. For example, considering the examples highlighted by the Board in BCIN.33:

(a) unit of account, e.g. accounting for regulatory assets/liabilities by rate-regulated entities;

(b) selection of a measurement basis for an asset or liability, e.g. an entity-specific current value may provide more relevant information about future cash flows than a fair value determined from the perspective of hypothetical market participants; and

(c) presentation and disclosure, including whether to include items of income and expenses in OCI, e.g. recognising within OCI changes in the fair value of a derivative held for hedging purposes.

Consistent with our views on stewardship reporting, we believe that accounting should more clearly reflect how an entity conducts its business activities rather than theoretical market values.

Question 17 – Long-term investment
Do you agree with the IASB's conclusions on long-term investment? Why or why not?

Rightly or wrongly, the Board is generally considered to favour current value measurements (in particular, fair value) over historical cost. Indeed, it is generally suspected that other Board members (now or in the past) instinctively share the Alternative View expressed by Mr Finnegan to the effect that current value is always more relevant than historical cost. Current value measurements are considered by many to encourage short-termism and thereby potential volatility in the financial markets and it was largely for this reason that accounting attracted the attention of the G20 in the aftermath of the financial crisis.

Against this background, the Board does have somewhat of an image problem to address and there is a need for accounting standards to be seen to encourage long-term investment. Whilst the discussion in paragraphs BCIN.35-44 about whether its standards encourage long-term investment perhaps comes across as rather defensive, we broadly concur with the conclusions reached by the Board.

For the reasons given in our answer to Question 1, we do believe that the Board's argument would be enhanced if it was to identify the provision of stewardship information as a primary objective of general purpose financial reporting in addition to providing information to support resource allocation decisions.

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).

Capital maintenance

We note that the discussion of capital maintenance in Chapter 8 is substantially unchanged from the existing Conceptual Framework and that, whilst the Board would consider revising that discussion of capital maintenance if it were to carry out future work on accounting for high inflation, no such work is currently planned.

Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power. Whilst the Board has an existing standard (IAS 29) that deals with hyper-inflationary conditions, it does not have a standard that addresses accounting in conditions of high (but not hyper) inflation. Most countries have experienced relatively low inflation in recent years but it is quite possible that conditions of high inflation such as were experienced in the 1970's will return in the foreseeable future. We therefore recommend that the Board initiates a research project on inflation accounting in order that it does not run the risk of being overtaken by future events.

We also suggest that the Board reflects on the discussion of the physical capital maintenance concept in the Conceptual Framework. Application of the physical maintenance concept requires the adoption of the current cost basis of measurement but in paragraph BC 6.23 the Board states that it "would be unlikely to consider selecting current cost as a measurement basis when developing future standards". Whilst the Board offers no justification for this statement, it seems to be clear that application of the physical capital maintenance concept is unlikely ever to be an option under IFRS. We believe that this should be made clear in Chapter 8 which currently gives the impression that application of the physical capital maintenance model is contemplated by the Board.

Excessive length

We have commented many times on the worrying trend exhibited by the Board's more recent accounting standards: excessive length and complexity that the Board seeks to disguise by relegating much of the content to various appendices. As a result, the Board's standards have become user unfriendly and difficult to understand, particularly by those whose first language is not English.

We had hoped that the Board would take the opportunity to arrest that trend by maintaining the Conceptual Framework as a relatively concise statement of the principles that underlie its accounting standards. Unfortunately, that opportunity has been missed. Prior to the 2010 amendments, the Conceptual Framework ran to only 26 pages. As currently drafted, the Conceptual Framework runs to 68 pages with an additional 115 pages in the Basis of Conclusions. We do not believe that the fundamental principles have become significantly more complicated over the years and find it difficult to understand why it now takes so many more words for the Board to explain those principles.