



International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

23 January 2014

Dear Sirs,

Re: Discussion Paper A Review of the Conceptual Framework for Financial Reporting

We are pleased to take this opportunity to respond to the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the DP).

In our response to the IASB's Agenda Consultation, Business Europe strongly supported completion of this project ahead of any new major standard-setting activities and therefore we welcome the priority it is being given. It is important that this is completed before the IASB considers any major new standard-setting activity. We also welcome the IASB abandoning its previous phased approach to this project, which we have objected to in the past as being inefficient and unhelpful to stakeholders.

The following are the main points we would bring to the Board's attention:

1. The Conceptual Framework (the Framework) is used extensively by preparers to understand and interpret the individual standards and to develop appropriate accounting policies in the absence of a specific standard dealing with the specific transaction. The Conceptual Framework should therefore be written in such a manner as to allow preparers to continue to use it in this way, rather than being written, as it appears to be in the DP, as a tool intended primarily for the Board.
2. We have concerns with the elimination of all reference to a probability threshold in the definitions of assets and liabilities and the recognition criteria. The DP proposes a "default" approach to recognition, whereby an asset or a liability meeting the relevant definition will always be recognised, unless the Board has identified the specific transaction and decided, through application of the criteria described in the DP, that it should not be recognised. This proposal means that any uncertainty about the likelihood of an asset or liability actually resulting in the flow of the related economic benefits would have to be reflected in the measurement of the element. We think that this will lead to the recognition of assets and liabilities that are not recognised currently, or that additional time and resources will have to be applied to the assessment, only to arrive at a similar result to that of the current Framework. We are not convinced that this will provide useful information and think that it will be onerous to achieve.



3. We welcome the Board's recognition that profit or loss is a useful and widely accepted performance indicator. While we recognise the Board's difficulty in arriving at a definition of this indicator, we think that it is very important that the Board define, or at the very least, identify the objectives of this indicator and describe its relevance. It seems to us that in recognising its importance to users and in identifying items to be recognised in OCI, the Board has taken a big step towards identifying what profit or loss is, and it would be regrettable for this not to be taken to a final conclusion. We think that as an essential part of this exercise the Board should also develop guidance to allow it to use the notion of matching to assist it in deciding what should be recognised in profit or loss in any given period.
4. The consideration of the business model to ensure that the economic substance of the entity's transactions is appropriately represented is key to financial reporting. Indeed, we think that the business model must be an important factor in guiding the Board both in its determination of the most relevant measurement method for assets, liabilities, income and expenses, and in its determination of the most useful presentation model for the financial statements. The fundamental role of the business model should therefore be given more emphasis and explanation than is accorded to it in the DP. In addition, explaining clearly in the Framework what is meant by the concept of the "business model" will avoid any misunderstanding about how it is intended to be used.
5. We would ask the Board to reconsider its decision not to revise chapters 1 and 3 of the Framework. The current Conceptual Framework assigns a secondary role to management accountability in the first chapter of the Framework (paragraph OB4). In contrast, the DP appears to place much more importance on the role of financial statements in facilitating the user's judgement of management's performance and accountability. We agree that this is an important aspect of the purpose of financial statements. Furthermore, we think that the notions of reliability and prudence should be reinstated, as we find these more relevant and understandable than the term "faithful representation". In particular, we do not believe that prudence is the enemy of neutrality but is rather the articulation of how the concept of neutrality can be applied so that it is entity-specific. In our view, if these notions are properly defined and explained, the misunderstandings perceived by the Board in this area can be overcome.
6. We agree with the proposed requirement for the Board to "comply or explain" departures from the Framework in setting the standards. We think that this approach fairly represents the fundamental importance of the role of the Conceptual Framework to the body of IFRS: it ranks de facto alongside the standards, rather than to be considered only after analogies to standards have been explored. Departures from the principles should be very rare and made only when fully justified. The Framework should therefore be written as a robust set of principles that can be kept constant over time, and the Board should be careful not to begin to define rules within the Framework.



7. We would encourage the Board to use the revision of the Framework as an opportunity to enable it to resolve some of the numerous difficulties currently encountered in the setting and interpreting of IFRS, such as, for example, that of NCI puts, variable consideration, the timing of the recognition of accruals/provisions etc.
8. Finally, we recommend that the Board include in the future Exposure Draft on the Conceptual Framework an analysis of the effects that the modification of the Framework would potentially have on the existing standards. This would help constituents understand more fully the implications of the proposals, some of which are not clear at present.

Our responses to the questions posed in the DP are set out in Appendix 1.

Yours sincerely,

Jérôme P. Chauvin
Director
Legal Affairs Department
Internal Market Department



Section 1 Introduction

Question 1

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

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

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

We agree with making the purpose of the Conceptual Framework (the Framework) more focused on the essential, which is, in our view:

- a. to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs;
- b. to assist other parties to understand and interpret existing Standards; and
- c. to assist other parties to develop accounting policies when no other Standard or Interpretation specifically applies to a particular transaction or event.

We think that the Board should not underestimate the extent to which preparers currently use the Conceptual Framework on a regular basis, for both the purposes listed at b. and c. above. Consequently, these purposes should not be considered "secondary" to that of the "primary" purpose of assisting the Board, but be set at a similar level. The Framework should therefore be drafted in such a way that it unambiguously allows preparers to apply its principles when specific standards do not deal with the specific economic event. We think that this is a basic requirement for, and fully consistent with, a principles-based set of accounting standards. To be consistent with this, the Framework should not contain guidance which is reserved only for the use of the IASB.

In addition, use of the Framework for these two purposes has important implications for the direction the DP has taken in respect of the asset and liability definitions and the recognition/derecognition criteria. We deal with this in our response to question 8.

The DP is quite long and detailed. Although this detail is helpful at this stage in the project, we think that the final Framework should be limited to providing high-level statements of strong principles and it should not delve into detailed accounting definitions or rules such as those given in Chapter 5 on the statement of changes in equity: these should be reserved for individual standards. Given that it is unlikely that the Framework would be able to envisage all the possible situations that may arise, we agree that the Board should be empowered to diverge from the robust principles of the

Framework in rare cases when setting standards, and that the reasons for such divergence must be well justified and clearly explained in the standards.

As the logical corollary to this, the status of the Framework would appear to be the equal of that of the standards. However, this does not mean that a standard can never diverge from the principles laid out. As long as it is clearly stated in the Framework that individual standards dealing with specific transactions for clearly explained reasons take precedence over general principles, we do not think that there is a real risk of preparers “trumping” standards with the principles of the Framework, as the Board fears (paragraph 4.11 of the DP).

In addition, although it is the Board’s intention not to re-open the chapters of the Framework that have recently been revised (Chapters 1 and 3), we think that these are of such importance that they should be reconsidered as part of this fundamental review of the Framework.

In particular, we think that the role of the financial statements as an essential vehicle in the relationship between current investors and the management of the entity should be reinstated as a primary objective (paragraph OB2), rather than being relegated to a tool for forecasting future cash flows as it is presented in the current paragraph OB4. Management should be held accountable for its past performance as well as being judged on how it is likely to perform in the future, and the financial statements are the primary vehicle to facilitate this. The representation of the entity must therefore be made in a language that can be understood both by investors and management to enable effective communication.

We are of the view that reliability and prudence should be reintroduced as qualitative characteristics alongside relevance.

We think that prudence is different from conservatism in the context of accounting. Conservatism is generally understood to refer to the practice of setting aside “reserves” to enable the entity to face (unidentified) difficult situations in the future. Such an approach will mislead users. Prudence, on the other hand, refers to the practice of not being unduly optimistic in one’s assessment of items. This has generally been described as the approach of being careful to avoid overstating assets or understating liabilities. It does not mean that assets are understated and liabilities overstated, and indeed, we would argue that it is a way of actually achieving a lack of bias (neutrality) while ensuring that the information reflects circumstances specific to the entity.

Neutrality is a more difficult concept to define in the context of entity-specific financial statements, and is, we think, more confusing on its own than when used in conjunction with the notion of prudence.

We note that in at least one speech the Chairman of the IASB has stated that IFRS reflect a prudent approach. We agree that this should be the case and we think that this ought to be clearly acknowledged in the Conceptual Framework.

Reliability refers to the nature of the financial statements and their components: the user should be able to rely on these without question and without having to recalculate

the amounts presented. In other words, the user should be able to have confidence in them.

We think that some of the difficulties perceived by the Board in respect of the notion of stewardship and the characteristics of prudence and reliability may stem, to a large extent, from the difficulty of translating these terms into other languages. The solution to these difficulties may be to provide a definition or description of what these terms are intended to mean and their purpose, rather than to replace them with other terms or notions which have their own inherent difficulties.

Finally, we are surprised that there is no explicit discussion of the principle of “matching” (referred to as “the matching of costs with revenues” in paragraph 4.50 of the current Framework) in the DP. We think that this principle is fundamental to the proper depiction of the performance of the entity in the profit and loss account. It is discussed implicitly in the section of the DP dealing with the presentation of profit or loss as the primary performance indicator, but it is such a fundamental notion that we think it warrants specific discussion and conclusions.

Section 2 Elements of financial statements

Question 2

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

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

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

It is unclear to us why the terms “present” and “as a result of past events” are both necessary to the definitions of an asset and a liability. The word present means that the item exists at the relevant date and should be sufficient on its own. The discussion on whether a liability exists at the balance-sheet date is a matter for detailed guidance as discussed in paragraphs 3.63-3.97 and under Question 6.

The use of the word “capable” in the definition of an economic resource might lead to a broadening of the scope of what satisfies the definition of an asset or liability. It is a term which may be interpreted in a very subjective way by different parties, and lead to tensions similar to those engendered by its use in the definition of a business in the Business Combinations standard. We expect that preparers will have to spend time identifying and assessing items which have a remote possibility of actually producing economic benefits, and we are not convinced that this is justified against cost-benefit criteria.



Although the definitions cited above may seem acceptable in isolation, we think that their use in conjunction with the proposal to use recognition criteria without a recognition threshold will lead to difficulties in practice, as discussed below.

Question 3

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

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

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

We do not agree with the elimination of the role of uncertainty from both the definitions of asset and liability and the recognition criteria. Although we understand the Board’s reasoning for wanting to eliminate the dual use of uncertainty in the current definitions and the recognition criteria, we think that a recognition threshold based on probability of existence and outcome should be developed in order to avoid the recognition of potentially many items which are unlikely to be realised and may thus not be useful information for users. In these proposals, treatment of uncertainty becomes, by default, an aspect of measurement and we do not think that this is optimal. We discuss the difficulties this raises in our response to question 8.

The Board has stated that existing standards will not be revised immediately but that the new Framework will be taken into account when standards are developed or revised. The consequence of the new definitions and recognition criteria may be that entities will be obliged to identify, assess, and potentially recognise and measure new assets and liabilities once the final Framework is published and becomes effective. We think that it is important, therefore, that the Board develop a transitional approach to dealing with the situation that new elements meet the definition and recognition criteria but current standards do not deal with them.

Question 4

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

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



The current description of revenue, gains, expenses and losses refers to “ordinary activities” of an entity, which are not further explained. In view of the importance that is accorded by many constituents to items that appear in profit or loss, and the proposal of the DP to recognise this as an important performance indicator, it may be helpful to define, or at least, to describe these elements in a way which more clearly indicates the link to profit or loss or OCI as performance statements, and explains why the Board thinks that use of OCI enhances the relevance of profit or loss.

The notion of matching, which is discussed in paragraph 4.50 of the current Framework, can, we believe, have a useful a role to play in the allocation of income and expenses to periods, and therefore warrants further consideration in the future Framework.

Section 3 Additional guidance to support the asset and liability definitions

Question 5

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

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

We think that the precedence of substance over form is an important principle of the Framework and therefore agree that the definition of a liability should continue to encompass constructive obligations.

Question 6

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

- (a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.
- (b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.
- (c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity’s future actions.



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

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

One of the difficulties with both the proposed (and existing) definition of a liability is the requirement for a “past event” to have occurred, and in particular, to identify the relevant past event.

In the current Conceptual Framework it is not clear, in the case of an executory contract, whether it is the signature of the contract (the commitment) that is the relevant past event giving rise to an actual liability (as implied by paragraph 3.110) or the performance by one of the parties. The discussion in the DP lists different practices which are applied in this area at present but does not clearly explain what, if any, are the principles behind the accounting. It is not clear whether executory contracts should not be recognised or be recognised but measured at zero, and whether executory contracts represent gross assets and liabilities or net items. These matters are fundamental to the accounting outcome of a number of economic events, but the DP does not clarify this sufficiently for conclusions to be drawn. We think that the Framework should provide clear principles in this area.

In respect of the more straight-forward liabilities, we agree with the Board's rejection of View 1. This is the approach reflected by the recent Interpretation on Levies (IFRIC 21) which, in focusing on the trigger identified in the relevant legislation, seems to favour legal form over economic substance in many instances. This approach does not provide the user with useful information about cash outflows which are virtually certain and sometimes imminent.

We think that when management has, in theory, the ability to avoid a liability by taking an unrealistic action, such as closing a significant section of its operations or ceasing to operate as a going concern, it should not be precluded from considering that it has an obligation before the occurrence of the last event/action. However, if the management has a real choice about whether to engage in the final action which will confirm the existence of the obligation, we would tend to think that there is not an obligation. Thus, for example, we agree with the recognition of the cost of unvested pension rights and the prohibition of accounting for future operating losses.

In order to help us to understand, and conclude on, the difference between Views 2 and 3, it would be helpful if the Board were to make it clear how these would compare with current IAS 37 and other standards, such as IAS 19, in their treatment of specific transactions such as, for example, restructuring provisions and unvested pension rights. The two tables 3.2 and 3.3 do not really make the distinction sufficiently clear.

However, based upon an initial and possibly imperfect understanding of the proposals, our members tend to think that View 3 would result in the recognition of too wide a range of liabilities, but there is broad support for View 2, which might be a better starting point from which to develop an approach to the recognition of liabilities.



As a final point of detail: under View 2 variable lease payments are identified as a liability on the grounds that the retailer does not have the practical ability to avoid making sales. However, the sales, and hence the rental payments, depend upon customers buying the retailer's products. We are not sure about this conclusion in the DP, and note that in the latest exposure draft of the future Leases standard the Board has decided to recognise only firm lease commitments, and in the future revenue-recognition standard the Board has decided not to recognise sales-related royalties until the related sales are made.

Question 7

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

We think that the Framework should also deal with the consequence of the recognition of a liability, that is, whether it results in an asset (right of use in a lease, decommissioning cost etc.) or an expense. In particular, it would be useful to define a concept behind the treatment of a change in the amount of a liability, as this continues to be a source of problems, as indicated by the numerous issues put to the IFRS Interpretations Committee. We note that variations in the amount of a liability often result from the refining of an estimate due to the obtaining of better information. We think that it would be helpful to establish a clear and simple principle, such as, for example, that the impact of a variation in a liability because of such a change should be accounted for in the same way as the original corresponding entry. A clear concept articulated in the Framework could help the Board in its resolution of the questions of NCI puts and variable consideration for asset purchases, and in developing the new leases standard, for example.

The DP is not clear in its discussion of the difference between executory contracts and other contracts, and whether a liability is not recognised or recognised but measured at nil value, or fully offset to give a net nil amount. The identification of the relevant "past event" is essential, but the proposals in the DP do not seem to help with this.

Finally, the DP states that "Treasury shares" are not assets because an interest in its own residual value cannot be an asset of an entity. However, there are a number of rights inherent in such assets which can be controlled and monetised by the entity and which would therefore appear to satisfy the definition of an asset as proposed in the DP. We would therefore suggest that to exclude treasury shares from recognition as an asset is actually a standard-level decision rather than a conceptual principle, and this assertion should therefore be excluded from the Framework.

Section 4 Recognition and derecognition**Question 8**

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



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

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

The proposal for recognition is that all assets and liabilities meeting the definitions are recognised unless the Board has decided otherwise on the basis of an assessment against the criteria listed – a “recognition by default” approach. This approach to recognition appears to us to present certain dangers as it is based on the premise that the Board has examined all possible assets and liabilities in all possible situations and identified those which should not be recognised. In view of the constant evolution in transaction types and the delay inherent in the standard-setting process, it is unlikely that the Board will ever be in a position to have considered and dealt with all transactions, and thus an approach of recognition by default may be inadvisable.

In addition, as a corollary to this approach, it appears that uncertainty about the existence or realisation of the outcome linked to an asset or liability will have to be dealt with through measurement techniques alone. We do not think it is helpful for several reasons:

- The recognition of items which have improbable inflows or outflows on the primary statements is not useful information (its proper place is in the notes);
- It is easier to apply judgement on the basis of a recognition threshold than to identify all (relevant) expected outcomes and to place probabilities on these; and
- Measurement of this sort requires a great effort in collecting and processing information with a remote possibility of occurrence, and we do not think that this will be justified on cost/benefit grounds; however, unless the Board has examined the specific issue recognition will be obligatory.

Implicit in the above is a consideration of relevance and reliability.

We would therefore recommend a recognition threshold based on probability be retained.

Question 9

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

- (b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk; or
- (c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

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

We agree that the derecognition criteria should ideally be the mirror-image of the recognition criteria. Use of a control approach requires the identification of the individual rights that are no longer controlled, and those that are still controlled, and the obligations which have been passed on to the third party and those that are retained, but we are not sure how this can be made to work in practice in the absence of a probability threshold and a clear articulation of how the risks and rewards belonging to both parties should be assessed and used in the decision to derecognise.

Approach (c) has the advantage of being simple to apply, but may not reflect the economic reality of the transaction. If the entity has transferred some of the rights attached to an asset, then a better depiction might be to reflect the change in the asset and the assuming of any obligations resulting from the transaction. On balance, approach (b) might provide the better depiction of the transaction.

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

Question 10

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

- (a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.
- (b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:
 - (i) obligations to issue equity instruments are not liabilities; and
 - (ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).
- (c) an entity should:
 - (i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.
 - (ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.
- (d) if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. Identifying whether to use such an approach, and if so, when, would still be a decision for the IASB to take in developing or revising particular Standards.



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

We agree with retaining the definition of equity as the residual interest. We also agree that the definition of the liability provides the simplest way of distinguishing liabilities from equity instruments; that obligations to issue equity instruments are not liabilities; and that liabilities occurring only on liquidation are not liabilities.

We are unsure as to the merits of the suggested “wealth-transfer” model, and in particular about how to interpret the changes that will be presented in the equity table. We think that the DP is not sufficiently clear in its explanation of this new idea.

We think that the discussion about the nature of equity claims and wealth transfer provides a good opportunity for the Board to clarify the notions of owners in their capacity as owners and NCI, as this may also indicate how to resolve the issue of NCI puts.

Section 6 Measurement

Question 11

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

- (a) the objective of measurement is to contribute to the faithful representation of relevant information about:
 - (i) the resources of the entity, claims against the entity and changes in resources and claims; and
 - (ii) how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources.
- (b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
- (c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;
- (d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
 - (i) for a particular asset should depend on how that asset contributes to future cash flows; and
 - (ii) for a particular liability should depend on how the entity will settle or fulfil that liability.
- (e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and
- (f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.



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

We agree with views (a)(i),(ii) and (b) on the objective of measurement and that a single measurement basis may not be the best approach.

We agree strongly with (c) that in selecting the measurement basis to use the IASB should consider the information that will be provided in the statement of financial position, in profit or loss and in OCI. However, to be consistent with the view that items in profit or loss provide the primary source of information about the return on economic resources (paragraph 8.40 Principle 1), the primary consideration should be on how the measure will affect profit or loss. Only if there are overriding reasons for a different measurement in the statement of financial position should a different measurement basis be selected for that statement, with the consequence that OCI will serve as the link between the two. For the sake of simplicity and hence ease of understanding, preference should be given to having the same measurement method for both profit and loss and financial position.

We strongly disagree with the statement in (d) that in choosing a measurement method priority should be given to the view of investors, creditors and other lenders as to how an asset or liability will contribute to cash flows. We think that the most relevant measurement methods are those that will be closest to the eventual outcome, and we are not convinced that it is the users that are best placed to do this. In our view, it is in this area that the business model should be of most value because of the facility it offers of identifying the measurement approach which will most correspond to the ultimate cash flow contributions and thus be of the most predictive value. The relevance of the measure should be judged in terms of closest alignment with the business model (and hence the best predictive value) and not how users might incorporate the value and rework it in their assessment models. Of course, the use made of information by users is an important consideration, but it should not override the objective relevance of the business model.

Question 12

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

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



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

While we agree with the direction of the preliminary views summarised above, we would not agree that assets which will contribute to cash flows by being sold should systematically be measured at a current exit price. Such a price would be inappropriate both for items to be sold in a normal operating cycle, such as inventory (as stated in paragraph 6.80), and for items where the sale or the sales price is still uncertain, such as sales of non-current assets. In addition, where a reliable fair value estimate is not available or achievable, such as one for a sale in an illiquid market, or one falling in level three of the fair value hierarchy, we do not think that fair value is an appropriate measurement method, even if the value of the item is to be realised through a sale. For these, the current “lower of cost or net realisable value” approaches are more relevant.

The DP discusses briefly the use of a measure based on the most profitable means of contributing to the entity (paragraph 6.75(b)). We think this notion may have merit but we think it requires further explanation and justification.

We note that paragraph 6.76 suggests that the issue of uncertainty about how the asset will contribute to cash flows could be dealt with by disclosure of a second measure in the notes. In view of the current recent debate about the volume of disclosures, we would be cautious about adopting this approach. We also wonder whether disclosure of different measures would lead to doubts about the faithful representation provided by the information given in the primary statements.

Question 13

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

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

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

We agree with these preliminary views. However, we do think that it would be helpful to explain clearly the distinction between a cost-based approach and a cash-flow-based approach, as these will often be essentially the same. The lack of clarity is partially due to the DP’s proposal that in certain cases cash-flow-based methods are used as a proxy for other approaches.



We note the DP uses the concept of “current market price” without defining it. If this term is to be retained in the future due-process documents and hence in the body of IFRS, we think that it should be defined and clearly distinguished from fair value, which has been largely defined in IFRS 13. Use of this new concept should be properly justified.

Question 14

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

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

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

We agree in principle with this preliminary view. However, we think there are contracts which could meet conditions (a), (b) or (c) and yet cost might still be the best measure. Examples of these could include take-or-pay contracts; other contracts not intended to be traded, such as long-term North-Sea gas-supply contracts, and investments in equity for the long term.

We think that the use of fair value can be counter-intuitive in certain situations. It is therefore important that the business model is used to reflect the economic substance of the transactions in the most appropriate way.

Question 15

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

We object to the extension of the use of “probability-weighted average” outcomes (“expected outcome” approach), as we think that the information provided by this method will in general not be useful since it will invariably be different from the final outcome. In our view, in most cases an approach which combines a probability threshold for recognition in conjunction with measurement on the basis of the most likely outcome is usually more useful to users.

We think that the Conceptual Framework should discuss the objective of the use of discount rates and establish principles for how these should be determined in order to achieve the consistency in use across the body of IFRS that is lacking in current standards.



Section 7 Presentation and disclosure

Question 16

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

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

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

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

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*.

Please see our responses to Questions 11 and 19 in respect of the importance and role of the primary financial statements.

We agree with the general direction on the scope and content of the guidance on disclosure. However, we think that, in contrast to the DP, the final Framework should not include specific examples of disclosure; these should be included as illustrations in individual standards.

We think that the discussion of what the objective of disclosures is and is not, as laid out in paragraph 7.36, is very useful and could helpfully be promoted to the section entitled "Objective of the notes to the financial statements".

Question 17

Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, the guidance in the *Conceptual Framework* on



materiality. However, the IASB is considering developing additional guidance or education material on materiality outside of the *Conceptual Framework* project.

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

We agree that materiality is dealt with adequately in the existing Framework. We are also aware that the Board is currently considering the addition of guidance similar to that of paragraph 7.46 in an amendment to IAS 1 as part of the “disclosure initiative”. In principle, these should be sufficient to clarify the application of materiality, but we await the final proposals to be able to judge this.

Question 18

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

Do you agree that communication principles should be part of the *Conceptual Framework*?

Why or why not?

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

We do not think that the Framework should consider the medium to be used for financial communication. To consider the requirements and constraints of XBRL, to take one example, when developing accounting standards, would be to put the principle-based setting of standards at risk of being subordinated to concerns about the communication tool, and this would be to the detriment of the quality of the information provided. What is important for the Board to determine is the clarity and relevance of the information provided and not the medium used, which is the concern of the entity or imposed by local regulation.

We are content with the other communication principles.

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

Question 19

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

Do you agree? Why or why not?

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

We think that profit or loss (or net income) is a fundamental indicator of an entity's performance and the single most important element in the entity's communication with



its owners, future investors and creditors. It is not the only performance indicator – the balance sheet, cash flow statement, OCI and other information all have important roles – but it provides a clearly identifiable and understandable starting-point for analysis and communication. We therefore think that profit or loss should be shown as a total in a statement of its own, and not as a sub-total, the importance of which might be eroded by future decisions of the Board at the level of an individual standard.

Profit or loss is not just a matter of presentation, nor is it just a derivative of the change in carrying amount of assets and liabilities: It is something more fundamental than that. It is a measure of how the entity has increased or reduced its wealth in the period in the context of its business model and the economic environment.

We think the Board must define, or at least describe, the purpose, objective or nature of profit or loss separately from OCI in the Framework in order to establish and protect its importance as a measure of performance. We recognise that this is not easy to achieve, but would point out that in defining the type of items that should be recognised in OCI, the Board must already have an idea of what should and what should not be included in profit or loss. As an illustration of this, the title of the section of the DP preceding paragraph 8.46 indicates that one should “recognise an item in OCI if that enhances the relevance of profit or loss”. This and the following discussion clearly indicate that the Board has a vision of profit or loss which it should be able to articulate. It may be possible to combine a number of the attributes analysed in table 8.1 to achieve this, instead of concluding on their use in isolation, as has been done in the DP.

We think that a notion of what income or expense is attributable to the period in the context of the business model may be helpful. This notion could also be used to inform the decision on what measurement method and presentation are relevant, and thus avoid the recording of items in profit or loss merely as the consequence of a decision made for the purposes of the balance sheet.

Furthermore, we think that this issue is really that of the fundamental concept of matching expenses and income to periods. In IFRS this concept is secondary to that of the recognition of assets and liabilities which meet the relevant definitions. While we do not disagree with this, we note that a frequent cause of mismatches is also the choice of measurement bases (illustrated by the use of OCI as a bridge or store of elements in current IFRS), and we would recommend that the Board consider whether and how the concept of matching could be reintroduced and articulated.

We do not agree with the statement in paragraph 7.31 of the DP that no primary financial statement has primacy over another. Furthermore, this is somewhat at odds with the Board’s recognition of the importance of profit or loss as stated, for example, in paragraph 8.46 “items within profit or loss provide the primary source of information about the return an entity has made on its economic resources”. We think that at the very least profit or loss is “the first amongst equals”.



Question 20

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

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

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

We think that all items of income or expense which result in cash in- or outflows should ultimately pass through profit or loss in its role as the primary indicator of performance. Decisions made by management and which result in cash flows (cost and revenues) should be reflected in profit or loss at some point. In contrast, fluctuations in value which result from measurements which are believed to be useful information for users by the Board but which will not be realised in the context of the entity's business model should be excluded from profit or loss. Consequently, those elements of income or expense, which are initially excluded from profit or loss because of their lack of relevance to the performance of the period, should eventually be recycled to the profit or loss statement as a matter of principle, unless they are naturally reversed within OCI. An appropriate time to recycle such items could be when the related item is disposed of (cumulative exchange differences or fair value changes) or when the related liability is settled (cumulative actuarial differences or fair value changes). The only exception to the principle of recycling should be in the case of items where the Board cannot identify a clear basis for recycling and thinks that no systematic and rational basis is acceptable. These cases should be rare.

Finally, in support of our view that cash flows should ultimately pass through profit or loss, we would point to the insistence of the current Framework on the need for users to have information to enable them to forecast cash flows. We think that our principle will assist users in understanding and forecasting the future cash flows generated from assets and liabilities.

Question 21

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

Which of these approaches do you support, and why?

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

We support the broad approach to the use of OCI (2B) but, as indicated above, this should be coupled with a presumption that all items recognised in OCI should be recycled.



We regret that the Board has not approached this topic with a “clean sheet of paper” but has rather taken what already exists as the basis for the identification of items to pass in OCI. Having said that, we think that the three categories of items for inclusion in OCI are valid, but also think that these categories should not be regarded as exhaustive, as to do so would be to exclude new types of items which may be identified by the Board in future projects.

Section 9 Other issues

Question 22

*Chapters 1 and 3 of the existing Conceptual Framework Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the *Conceptual Framework* highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.*

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

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

Yes, we believe that those chapters should be revised: see our response to question 1.

Question 23

Business model

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

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

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

Should the IASB define ‘business model’? Why or why not?

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

We think that the term “business model” describes how an entity preserves or increases value and generates cash flows. In order to help users understand and predict the performance of the entity financial reporting should endeavour to represent the business model in the most faithful way, that is, the way that most closely



represents the final outcome of the entity's activity. We therefore think that the concept of the business model and its use in selecting measurement and recognition models relevant to the entity is an essential part of the standard-setting process.

We agree that the use of the notion of the business model can be helpful in ensuring that the accounting model best reflects the most likely way in which the asset or liability will affect the cash flows of the entity. As an illustration of the different ways the same transaction in the same entity could contribute to cash flows in different business models, we offer the example of the purchase of a commodity which could be (a) for own use in production or for resale to retail clients, (b) for hedging purposes, or (c) for trading. These uses represent three different business models and it is appropriate for the accounting to take this into account – the same accounting for all three models does not, in our view, provide the most relevant or useful information to the user.

We agree with the Board's preliminary view expressed in paragraph 6.17 that the selection of a measurement method for a particular asset should depend on how it contributes to future cash flows and for a particular liability should depend on how the entity will settle or fulfil that liability. This assessment should include consideration of the appropriate impact on profit or loss. We think that this is an approach which takes into account the business model and that it would be helpful to make this explicit in the Framework. Following on from this, we think the Board should explicitly include consideration of the business model as a compulsory step in the development of all accounting standards, as it already has in its recent development of the accounting for financial assets in IFRS 9.

As the purpose of the use of the notion of the business model is to help the Board identify the most appropriate accounting model for individual transactions, it should be responsive to the objectives of financial reporting described in paragraphs OB3 and 4, that is, to assess an entity's prospects for future net cash flows and the effectiveness of management, in the way that best corresponds to the actual outcomes. To do this, the model should describe how the entity preserves or increases value and generates cash flows.

We think it should be made clear by the Board that the term "business model" in this context is not the equivalent of an industry accounting model, but is a tool intended to aid the Board in determining the measurement and presentation approaches that best reflect the underlying economic substance of the transactions. The notion is based on the identification of the most likely outcome of the transaction, in terms of cash flows, in the context of the use made of the element concerned.

Finally, it should be made clear that it is the Board's role to identify the types of business model that can be distinguished for accounting purposes and it is the entity's role to assess which model applies to its specific activities. The identification of the model by the entity should be a matter of observable fact and not a matter of management intention or aspiration.



Question 24

Unit of account

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

Do you agree? Why or why not?

We agree with the IASB’s preliminary view summarised above.

We would emphasise that where physical assets are concerned, the principle should always be to treat all the rights inherent in the physical asset as a single unit, unless some or all of the rights related to that asset have in fact been separated and transferred to one or more third parties. We think that the Board should not break up assets into separate rights for separate treatment without very clear explanation and justification, since we expect that the identification and measurement of such individual rights would be a burden to the entity and of dubious value to the user.

Question 25

Going concern

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

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

We see no further situations.

Question 26

Capital maintenance

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

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

We have no comment to make on this.

Other matters: Control vs. Risk and Rewards

The development of the future standard on revenue recognition marks the transition from what may be called the “transfer of risk and rewards” approach of IAS 18 and IAS 11 to the “transfer of control” approach of the future standard. These approaches can be used for other items, such as financial instruments, and it would therefore be helpful if the Framework contained a discussion of the relative merits of these approaches and an indication of which should be used and in which circumstances.