

EFRAG
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EFRAG public consultation: Exposure Draft *Conceptual Framework for Financial Reporting*

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) has the following comments regarding the EFRAG draft comments on the IASB Exposure Draft Conceptual Framework for Financial Reporting, ED/2015/3 (ED), and the specific questions raised by EFRAG regarding the proposals in the ED.

Summary of views

- On an overall basis, we are positive to the IASB's proposal and we believe that the revisions together with the added sections forms a more complete framework than the current.
- We believe that there are passages of the proposal that appears less comprehensible from a preparer perspective. One such example is the delineation of executory contracts.
- In our opinion, the IASB's approach to the concepts of stewardship and prudence is well balanced and we believe that the primary users of financial statements have been correctly identified in the framework.
- Currently, we believe that there is an overuse within the IFRS of measurements of current value based on discounted cash flow models.
- We believe that the uses of other comprehensive income could have been further clarified in the proposal. However, a delay of the final framework would be unfortunate so we don't think the IASB should take any action in this area at this late stage.

Specific comments on the questions raised by the IASB and EFRAG are provided in the Appendix below. In addition to our comments on the EFRAG draft, SEAG plans to post a separate reply to the IASB. We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE



Sofia Bildstein-Hagberg

Secretary of the Swedish Enterprise Accounting Group

The Swedish Enterprise Accounting Group (SEAG) represents more than 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.

Appendix – Comments regarding EFRAG’s response on the specific questions raised by the IASB and answers to specific questions to constituents

Q 1 (a) Stewardship

SEAG supports that assessment of management stewardship is acknowledged as a constituent in the depiction of the objective of financial reporting. We believe IASB’s proposed description of management stewardship as an element in the assessment of both changes in economic resources and financial performance is properly balanced. We do not share EFRAG’s view that the assessment of management stewardship should be an objective in its own right.

Question to constituents

Throughout the ED, ‘users’ refers to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

Do you agree with focusing on this group of users? If not please indicate how it should be either narrowed down or widened, and why.

We believe the primary users of financial information are correctly identified in the ED.

Q 1 (b) Prudence

SEAG supports that the notion of prudence is reintroduced in the framework. Unlike EFRAG, we believe that the proposed linkage that designates prudence as an aspect of neutrality will work well.

Q 1 (c) Substance over form

We agree with EFRAG that the reintroduction of substance over form in the framework is a welcome contribution. However, as the concepts of legal form as opposed to economic substance are broadly established in practice, we do not see a need for further clarification in the framework.

Q 1 (d) Measurement uncertainty

Unlike EFRAG, we support that measurement uncertainty is described as a factor that can make financial information less relevant. As there is a trade-off between measurement uncertainty and other factors that make information relevant that will vary from case to case, we don’t believe that a more specific explanation of the boundary of a reliable measurement would be of benefit to the framework.

Q 1 (e) Relevance and faithful representation

We support that relevance and faithful representation are identified as the two fundamental qualitative characteristics of usefulness.

Question to constituents

EFRAG's preliminary answer to Question 1(d) includes arguments for using the term 'reliability' instead of 'faithful representation'. EFRAG would, however, wish to assess whether constituents have become used to the term 'faithful representation' introduced in 2010, have a good understanding of it, and therefore would prefer not to revert to 'reliability'. What is your assessment of this?

We believe that faithful representation, as a concept, is easier to grasp. We therefore prefer faithful representation over the term reliability.

Q 2 Description and boundary of a reporting entity

We agree with EFRAG's draft response. We do not support the assertion in paragraph 3.23 that consolidated financial statements are more likely to provide useful financial information. We do not see why there is a need for such a statement in the framework.

Question to constituents

Do you agree that there is no urgent need to justify the choice of control as the basis for consolidation from a conceptual perspective? If no, please explain what EFRAG should recommend to the IASB.

We think that the IASB better should have explored the possibility to introduce a coherent definition of control within the framework. However, as this would much likely cause a significant delay of the process, we don't believe that EFRAG should recommend the IASB to make any further justifications of this concept within the framework at this point.

Q 3 Definitions of elements

SEAG agrees with all the proposed definitions of elements. Unlike EFRAG, we believe that the connection between the definitions of assets and liabilities, i.e. that the framework states that what is an asset for one party is a liability for another party, is vital. However, to avoid misunderstandings the framework could benefit from a more distinct declaration of the difference between the existence of assets/liabilities on one hand, and on the other hand the recognition criteria for these elements.

Question to constituents

Do you agree with the view that the asset liability approach leads to more robust and consistent financial reporting than a pure matching approach?

For a coherent framework, we believe that one approach has to be superior to the other. This does not mean that the matching concept should be rejected. As the asset liability approach is well established, we do not see the need for a change in view.

Q 4 Present obligation

We agree.

Question to constituents

Although the change proposed appears appealing, EFRAG notes that it could have far-reaching consequences that need to be assessed. EFRAG will therefore during the comment period collect input on the proposed definitions.

SEAG has not seen any apparent consequences of the proposed change.

Q 5 Other guidance on the elements

We agree with EFRAG that the description of executory contracts in paragraphs 4.40-4.42 is difficult to comprehend. Other than that, we believe that the proposed guiding principles and examples illustrating the definitions are satisfactory.

Q 6 Recognition criteria

We agree with the proposed approach to recognition.

Q 7 Derecognition

SEAG agrees with the proposed guidance on derecognition.

Q 8 Measurement bases

SEAG agrees with the identified measurement bases. We do not see the need for alternative market based measures other than those presented in the proposal.

Q 9 Factors to consider when selecting a measurement basis

We think the connection between measurement bases and information quality could be described better in the framework. In this regard, we agree with EFRAG's view that the framework should provide more guidance on the selection of measurement bases.

On an overall basis, we believe that the measurement of current value for non-financial assets based on discounted cash-flow models is to widely

accepted. The use of this measurement approach ought to be restricted to a minimum for this type of assets. The element of measurement uncertainty in these estimations is, in most cases, too high. Nevertheless, these measurements can have a vital impact on the financial statements, the best example being the impairment test of goodwill. This is one of the most vital flaws within the IFRS, and we believe that the IASB needs to address this problem promptly.

Question to constituents

The ED includes different factors to consider when selecting a measurement basis. For example, the ED mentions in paragraph 6.54 that to produce relevant information it is important to consider both how an asset or liability contributes to future cash flows and the characteristics of the asset or the liability. Sometimes these factors could conflict and different conclusions could thus be reached by giving priority to some factors rather than to others. In the paper Profit or loss versus OCI prepared for the July 2015 ASAF meeting, EFRAG examines an approach where the business model will be used when selecting a measurement basis and thus when selecting among different factors.

What aspects do you think should help the IASB select a measurement basis when the factors listed in the ED would conflict? Do you think that some factors are more important than others?

In our opinion the reference to business models as a starting point for selecting the proper measurement basis is an issue for individual standards, and not the conceptual framework. As mentioned, we believe the framework should provide more guidance on the selection of the measurement bases. As we believe that current value measurements under some circumstances provide little information relevance, we believe that such guidance should be clearer on when such circumstances are present.

Q 10 More than one relevant measurement basis

SEAG agrees with EFRAG that there are cases where more than one measurement base is relevant and that these cases should not be referred to as an exception.

Question to constituents

Do you support the use of different measurement bases for the statement of financial position and the statement of profit or loss? If so, when do you think it would be appropriate?

Yes, under some circumstances it is justified. We believe the current uses of OCI is a good illustration of situations when it is appropriate to use current values in the statement of financial position, but presenting changes in current values would obstruct with the relevance of the statement of profit and loss.

Q 11 Objective and scope of financial statements and communication

We generally agree on the description of the objective and scope of financial statements.

Q 12 Description of the statement of profit or loss

We support the proposed description of the statement of profit or loss.

Question to constituents

The alternative view of Stephen Cooper and Patrick Finnegan presented in paragraphs AV2 – AV7 of the Basis for Conclusions accompanying the ED, notes that identifying the statement of profit or loss as the primary source of information about financial performance, but without actually defining financial performance or specifying the characteristics of income and expenses that require their presentation in OCI, will leave the IASB in effectively the same position that it is now. In addition, the approach to recycling provides little guidance, because there are no specific reasons presented that would rebut the presumption that recycling takes place (other than the reference to relevance).

Mr Cooper and Mr Finnegan think that the conceptual foundation for performance reporting should be based on principles of separate presentation of income and expenses with different characteristics, including, for example, different degrees of persistence and different predictive values, and principles of disaggregation or splitting of items of income and expenses to highlight components that have different characteristics. In general, such disaggregation should be done within profit or loss, either on the face of the statement or in the notes. However, Mr Cooper and Mr Finnegan acknowledge that there may be some circumstances in which disaggregation may be best done by recognising some components of income and expenses in OCI and not in profit or loss. Nevertheless, they believe that the Conceptual Framework should restrict the use of this approach (unless the IASB chooses to depart from the Conceptual Framework) more than the Exposure Draft proposes.

What is your opinion about this alternative view?

We do not agree that the conceptual framework should restrict the use of OCI in the proposed way. In addition, we fear that the informational output of income disaggregation may be unduly complicated and difficult to comprehend. We therefore doubt that the cost of providing the information can be justified in terms of information usefulness.

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

We agree with the IASB that the statement of profit or loss should be as inclusive as possible. However, we also believe that there are situations that justify the use of other comprehensive income. Such situations should not automatically be depicted as exceptions from a general rule. We also think the uses of other comprehensive income need to be explained further in the framework.

Question to constituents

The alternative view of Stephen Cooper and Patrick Finnegan presented in paragraphs AV2 – AV7 of the Basis for Conclusions accompanying the ED, notes that amounts could be recognised outside profit or loss, but only if doing so enhances the relevance of the information in the statement of profit or loss in that reporting period. Moreover, they think that this must also hold true for all other periods that may be affected, including periods covered by any potential recycling, and also in aggregate over several periods, including the life of

the transaction concerned. To achieve this, the basis of disaggregation should result in a net zero accumulated amount in OCI over the life of a transaction or in aggregate over the life of economically linked transactions. If the cumulative amount in OCI is not zero, then the relevance of the information in the statement of profit or loss is reduced on a cumulative basis, because some items of income and expenses would be entirely omitted from the statement of profit or loss and so the depiction of financial performance in that statement would not be complete. They also believe that the principle they outline would obviate the need to consider explicit reclassification of OCI items (because the disaggregation should naturally result in zero cumulative OCI over the life of the relevant transactions) and would therefore remove a source of complexity and confusion for users of financial statements.

Mr Cooper and Mr Finnegan consider that this principle would, in effect, restrict the use of OCI to a limited number of cases in which either (1) a different measurement basis (which, as noted in paragraph BC7.49, should be a meaningful measure and not just an accumulation of amounts recognised in the statement of profit or loss) is judged appropriate for measuring income and expenses in profit or loss, compared with that best suited to the measurement of the asset or the liability in the statement of financial position; or (2) there is a mismatch in the recognition basis for different but economically related transactions.

The Discussion Paper A Review of the Conceptual Framework for Financial Reporting presented three concepts to be used when considering whether an item could be reported in OCI. The three items were 'bridging items'; 'mismatched remeasurements' and 'transitory remeasurements'.

Mr. Cooper and Mr Finnegan thus supports two of the three situations for use of OCI envisaged in the Discussion Paper. Mr Cooper and Mr Finnegan believe that further work to develop a conceptual basis for OCI should have built on these.

What is your opinion about this alternative view?

Do you think the discussion about the three concepts from the Discussion Paper ('bridging items'; 'mismatched remeasurements' and 'transitory remeasurements') should be included in the Conceptual Framework?

We support a broader approach to the definition of OCI. Inclusion of the three concepts from the Discussion Paper could, in our opinion, enhance the usefulness of the Conceptual Framework as a description of the general categories of the uses of OCI.

Q 14 Recycling

As a general principle, we believe that all income and expenses included in other comprehensive income should be recycled to the profit and loss statement. We agree with EFRAG that the conceptual framework do not need to include an exception to this principal rule.

Capital maintenance

Question to constituents

The IASB has carried forward the material in the chapter on capital maintenance unchanged from the existing Conceptual Framework, except for a limited number of editorial changes. The Discussion Paper A Review of the Conceptual Framework for Financial Reporting preceding the ED noted that the IASB does not plan to consider the chapter on capital maintenance until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

EFRAG notes that an argument for removing the chapter until the issue can be further considered could be that the chapter is not well linked with other parts of the proposed new Conceptual Framework (e.g. it is not linked with the objective of general purpose financial reporting including the role of stewardship).

Do you think the existing chapter on capital maintenance should be kept in the Conceptual Framework?

SEAG refrains from commenting on this.

Q 15 Effects of the proposed changes to the Conceptual Framework

SEAG agrees with IASB's analysis.

Question to constituents

Do you agree with the status of the Conceptual Framework (see paragraphs 178 - 179 above) and that the review should not automatically result in any changes to Standards?

We agree.

Q 16 Business activities

In general, the purpose of the framework should be to provide general principles applicable to all reporting entities. We fear that the framework would lose significance if divergent principles are applied concurrently depending on the business model. In the long run, such an approach could affect the coherence of individual standards and thus the relevance of financial statements. However, under some circumstances references to business activities could be relevant when preparing individual standards. For this purpose, the conceptual framework would benefit from a better description of when this approach to standard setting is appropriate. In addition, business activities as a concept for standard setting should be better defined in the framework.

Q 17 Long-term investment

We agree with IASB's conclusions on long-term investments.

Question to constituents

Do you agree that:

- The ED provides sufficient guidance on how to reflect long-term investment business models;
- The ED contains sufficient and appropriate discussion of primary users and their information needs, and the objective of general purpose financial reporting, to address appropriately the needs of long-term investors?

Yes, we do agree that the ED provides sufficient guidance on how to reflect long-term investment. We also believe that the needs of long-term investors are appropriately reflected.

Ideas included in the Discussion PaperQuestion to constituents

Are there any of the discussions, ideas and reflections included in the Discussion Paper A Review of the Conceptual Framework for Financial Reporting (issued by the IASB in July 2013), that are not reflected in the ED, you think should be included in the Conceptual Framework?

No.