

JOINT OUTREACH EVENT

IASB EXPOSURE DRAFT ED/2015/3

**CONCEPTUAL FRAMEWORK FOR
FINANCIAL REPORTING**

MADRID

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This feedback statement has been prepared for the convenience of European constituents by the EFRAG Secretariat and has not been subject to review or discussion by either the EFRAG Board or the EFRAG Technical Expert Group. It has been reviewed by the IASB staff and has been jointly approved for publication by representatives of EFRAG and the ICAC who attended the joint outreach event.

Joint Outreach Event

This feedback statement has been prepared for the convenience of European constituents to summarise a joint outreach event held by EFRAG and the ICAC, in cooperation with the IASB, on 21 September 2015.

The joint outreach event was chaired by Ana María Martínez-Pina García, Chairman of the Instituto de Contabilidad y Auditoría de Cuentas (ICAC).

The joint outreach event was one of a series organised across Europe following the publication of the IASB Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting* ('the ED'). The purpose of the outreach event was to:

- stimulate debate on the Conceptual Framework in Europe;
- obtain input from European constituents and to understand their main concerns and wishes, in particular from those that may not intend to submit a comment letter to the ICAC, the IASB or EFRAG;
- receive input for the ICAC's comment letter to EFRAG and the IASB; and
- learn whether the preliminary comments as set out in EFRAG's document for public consultation were shared by European constituents.

Rachel Knubley (IASB Technical Principal) presented the ED on selected issues and Rasmus Sommer (EFRAG Senior Technical Manager) summarised EFRAG's document for public consultation. An open debate then took place with participants.

The participants had different backgrounds, including preparers, auditors, regulators and academics.

Issues covered

The topics covered in the outreach event were:

- objective of general purpose financial reporting and qualitative characteristics of useful financial information;
- elements of financial statements, recognition and derecognition;
- measurement, presentation and disclosure; and

- other comments from participants.

Comments received

The objective of general purpose financial reporting and qualitative characteristics of useful financial information.

Some participants expressed the view that primary users could have conflicting information needs. For example, some believed that the notion of 'prudence' is more closely aligned with the interests of creditors and long-term investors, than with the interests of shareholders and short-term investors.

In the ED, the IASB confirms that existing and potential investors, lenders and other creditors are the **primary users** of financial statements.

One participant identified two different types of users, who had conflicting information needs: shareholders and creditors/lenders. Shareholders were typically focused on the company's ability to distribute dividends, while creditors/lenders were focused on the company's creditworthiness and capability to repay debt. He questioned whether the introduction of prudence, a concept that would, in his view, accommodate creditors/lenders' interests, would be in conflict with the shareholders' interests. He argued that having prudence as a qualitative characteristic of useful information would lead to conservative financial statements, rather than financial statements that reflect the company's real performance.

One participant considered that long-term investors should be specifically mentioned in the Conceptual Framework and that society at large should be considered as a 'user' of general purpose financial reporting

One other participant commented that a similar conflict could exist between those who had a 'short-term investment' (e.g. short-term equity investors) and those providing 'long-term financing' (e.g. lenders and long-term equity investors). Some lenders have a long-term relationship with the company and are interested in having prudence in the accounting, while short-term investors are mainly interested in dividends and short-term gains/losses from changes in fair value. The participant considered that long-term investors should be specifically mentioned in the Conceptual Framework. This participant also thought that financial statements were useful not only to investors, lenders and other creditors but to a wide range of users, particularly if society at large was at risk (e.g. in the case where a company needed to be bailed out). Thus, he thought that society at large should be considered as the user of general purpose financial reporting.

Ana María Martínez-Pina García agreed that financial statements were important to a wide range of users, such as employees, prudential and market regulators. Nonetheless, she did not regard these users as 'primary users' of financial statements and agreed with those identified in the Conceptual Framework.

One participant asked who the primary users were, particularly if the company was not listed in a public market and had no loans. The

technical principal of the IASB clarified that the primary users were those who provided capital to the company.

In terms of primary users' information needs, she considered that the needs of investors could be similar to, and converged with, the needs of creditors. For example, both need information that is useful to assess the reporting entity's prospects for future cash flows.

One participant considered that it was vital to better reflect risk management and how management ran its business in the financial statements. This would help users to analyse management's stewardship.

In the ED, the IASB proposes to give more prominence to the importance of providing information needed to assess management's **stewardship** of the entity's resources.

An auditor considered that the importance of the 'going concern assumption' had been considerably magnified by the financial crisis. Nonetheless, he believed that the right way to deal with 'risk management' was to give more prominence to the concept of 'stewardship'. As an example, he referred to some European banks that had been significantly exposed to the U.S. subprime mortgage crisis and mentioned the fact that stakeholders had been surprised to discover the risks taken by management. He considered that it was important to have financial statements more focused on helping users to assess management's stewardship. For example, it would be useful to have more information about how management runs the business and manages risk. Finally, he considered that this information would be important not only to investors, lenders and other creditors, but also to society at large.

The technical principal of the IASB agreed that it was important for users to have information about the level of risk associated to the profit reported by a company. She believed that this discussion was closely linked to the concept of 'stewardship' and demonstrated the need for this concept to be reflected in the Conceptual Framework.

A number of participants welcomed the reintroduction of an explicit reference to the notion of prudence, but considered that there was room for improvement in the way the ED defined prudence and its interaction with other concepts, such as 'neutrality', and other standards.

In the ED, the IASB proposes to reintroduce an explicit reference to the notion of **prudence** and to state that prudence is important in achieving neutrality. However, the IASB detailed that the Conceptual Framework should not identify asymmetric prudence as a necessary characteristic of useful financial information.

One preparer considered that the definition of prudence should be improved as entities often viewed 'prudence' as something related to "being cautious about the recognition of assets and liabilities".

A number of participants considered that there was room for improvement in the way prudence was defined in the ED and its

interaction with other concepts such as ‘neutrality’ and with other standards. More specifically, some participants considered that:

- ‘asymmetric prudence’ was already reflected in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* where assets and liabilities were treated asymmetrically in terms of recognition;
- neutrality could be applied when the level of uncertainty was low. However, when there was a high level of uncertainty and risk, prudence would have to be applied;
- prudence was directly linked to neutrality. When management is being prudent (on its judgements and estimates) in an environment of uncertainty, then it is also being neutral;
- the definition of prudence included in the ED would not be compatible with the requirements in IFRS 3 *Business Combinations* on the recognition of a gain in a bargain purchase.

Ana María Martínez-Pina García agreed with the introduction of prudence and considered that it would be useful to introduce the notion of ‘asymmetric prudence’ in the Conceptual Framework, as it would clarify what prudence is and would align this concept with what auditors and preparers think about prudence.

The technical principal of the IASB acknowledged that preparers, users and academics held different views on how prudence should be defined and that the IASB was trying to reconcile those differences.

Elements of financial statements, recognition and derecognition

Participants discussed whether the proposed changes to the definitions would imply more assets and liabilities being recognised.

In the ED, the IASB discusses the definitions of the elements of financial statements (for example, assets, liabilities, equity, income and expenses) and proposes new definitions for these elements.

Ana María Martínez-Pina García noted that the IASB proposed removing the notion of ‘expected or probable outflows or inflows of resources’ from the definitions of assets and liabilities. She asked whether this change would imply the recognition of more assets and liabilities. The technical principal of the IASB stated that although more assets and liabilities would in theory meet the definitions, she did not expect more recognition of assets and liabilities — for an asset or liability to be recognised, it would need to satisfy the proposed recognition criteria.

One academic noted that the IASB proposed a number of changes to definitions in the Conceptual Framework. However, he questioned whether the final outcome was substantially different from what

already existed. He also asked for more information about the practical consequences of those changes.

The Senior Technical Manager of EFRAG explained that, in order to better assess how the definitions of assets and liabilities included in the ED would be interpreted, EFRAG would launch a questionnaire in which participants would be asked to assess whether different arrangements would result in items meeting the various elements of the proposed definitions. The technical principal of the IASB added that the overarching aim was to improve the Conceptual Framework by providing a more complete, clear and updated set of concepts. It was not the objective to fundamentally change the Conceptual Framework.

Some participants thought that the ED did not sufficiently acknowledge the importance of the ‘matching principle’.

Some participants considered that the ED did not sufficiently acknowledge the importance of the ‘matching principle’ (i.e. the importance of matching income and expenses) and called for more guidance. One participant referred to the accounting for levies, where there had been a call for the matching approach.

The technical principal of the IASB underlined that the intention to match income and expenses should not justify the recognition of items in the balance sheet that would not meet the definitions of assets or liabilities.

One participant asked whether the definition of ‘economic resources’ embodied assets only. One other participant welcomed the definition of ‘economic resources’, including the reference to ‘rights’.

One participant noted that according to the ED a liability is a present obligation of the entity to transfer an ‘economic resource’. He questioned whether the meaning of ‘economic resources’ encompassed assets only, and if so, whether this would be the right term to use in relation to a liability.

The technical principal of the IASB explained that ‘economic resources’ was a broad concept. It referred to “rights that had the potential to produce economic benefits”. One participant supported this definition and welcomed the use of the word ‘rights’.

Measurement, presentation and disclosure

Participants considered that it was important to define profit or loss and noted that the ED did not specify in which circumstances a certain type of measurement basis could be applied.

In the ED, the IASB suggests a mixed measurement model and describes the statement of profit or loss (P&L) as the primary source of information about an entity’s financial performance in a period. It includes a rebuttable presumption that income or expenses should be reported in profit or loss. That presumption can only be rebutted (resulting in income or expenses being reported in OCI) if those income or expenses are related to assets or liabilities measured at current values and if such classification would enhance the relevance of the information.

Some participants raised concerns about the statement of comprehensive income. More specifically, some participants:

- highlighted the importance of the line item 'profit or loss' and considered that the ED had failed to define it;
- considered that profit or loss should be presented in one statement, together with other comprehensive income. This would ease the analysis of all components related to performance, including those gains and losses that were reported in OCI;
- supported the use of the business model approach when deciding whether income and expenses should be reported in profit or loss or OCI; and
- thought that it was not useful to have a blurred distinction between profit or loss and OCI that led to different presentation requirements. The technical principal of the IASB replied that it was difficult to find a definition of profit or loss and noted it would be best to address whether to have a single statement of financial performance at a standards level. Nonetheless, she acknowledged the fact that some users overlooked amounts in OCI, and that the IASB would have to carefully consider the prominence of OCI.

In relation to measurement, Ana María Martínez-Pina García had the impression that the IASB had taken into account the principles that already existed in a number of new standards, such as IFRS 9 *Financial Instruments*, and integrated them in the Conceptual Framework. The technical principal of the IASB agreed that some of the principles included in the new standards, that seemed to work well, had been considered by the IASB when developing proposals for the Conceptual Framework.

One participant noted that the ED discussed different measurement bases, the information that they provided, and their advantages and disadvantages. However, the ED did not specify in which circumstances a certain type of measurement basis should be applied. He questioned whether stakeholders would be satisfied with such an approach; in particular, whether they would like more guidance on the selection of a measurement basis.

The technical principal of the IASB explained that, at the discussion paper stage, the IASB had provided more comprehensive guidance about the selection of a measurement basis. However, a number of respondents considered that the guidance was too detailed. The IASB was trying to achieve a balanced approach.

Other comments from participants

Participants were concerned about the fact that standards may override the principles established in the Conceptual Framework.

Participants considered that it was important to have standards and interpretations (e.g. IFRS 21 Levies) that would not override the principles established in the Conceptual Framework. In their view, the Conceptual Framework should have priority over the standards; not the opposite. Ana María Martínez-Pina García added that, in Spain, the Conceptual Framework was part of the law and it was integrated in local GAAP. Finally, she suggested that when a standard departs from the Conceptual Framework, the IASB should clearly explain the reason for that departure.

One participant asked whether the IASB intended to provide more guidance about combined financial statements in the future.

One participant noted that the ED did not provide detailed guidance about combined financial statements and asked whether it was the IASB's intention to provide more guidance in the future. One other participant noted that the Conceptual Framework did not make any reference to the equity method, including whether it was a one-line consolidation or a measurement basis.

The technical principal of the IASB acknowledged some of the concerns relating to the fact that standards may override the principles established in the Conceptual Framework and explained that such cases should be rare and well justified. She also replied that when a new Standard or amendment is both an improvement to current accounting and incompatible with Conceptual Framework, it would be challenging to wait for a change in the Conceptual Framework before making the necessary changes to the standard. The technical principal of the IASB also replied that the IASB had no current plans to provide further guidance on combined financial statements. Nonetheless, it would depend on the feedback received from respondents. She also noted that the IASB had a research project on *Equity Method of Accounting*.

Closing remarks

Ana María Martínez-Pina García thanked speakers and participants for their valuable input. Ana María Martínez-Pina García concluded the meeting by stating that the Conceptual Framework was a fundamental tool for standard setters and emphasised that it was important to have sufficient guidance in the Conceptual Framework to help standard setters develop a solution when no standard applied to a particular transaction or event. Finally, she considered it important that, if a standard were to depart from the Conceptual Framework, the IASB should clearly explain the reason for that departure in the basis for conclusions.