Federation of European Accountants
Fédération des Experts comptables Européens

Ms Françoise Flores
TEG Chair
EFRAG
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E-mail: Commentletters@efrag.org
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Ref.: ACC/PFK/HBL/PPA/VRA

Dear Ms Flores,

**Re: FEE comments on EFRAG's public consultation "Exposure Draft: Conceptual Framework for Financial Reporting"**

(1) FEE (the Federation of European Accountants, www.fee.be) is pleased to provide you below with its views and comments to the questions raised by EFRAG in its public consultation "Exposure Draft: Conceptual Framework for Financial Reporting" (ED).

(2) FEE welcomes the IASB's ED and EFRAG's initiative to issue a consultation document on some aspects of the ED. In general we support the IASB's project as we understand the importance of the Conceptual Framework for Financial Reporting in the future development of IFRS. A complete, updated and robust framework would assist the IASB in its standard setting process, preparers in selecting accounting policies, users of financial statements and other constituents to better understand and comprehend the principles of IFRS, including the external auditors. In the appendix we include our comments on the detailed questions that EFRAG raised in its consultation paper.

**Comments on EFRAG's consultation paper**

(3) We list below some areas where FEE does not agree with EFRAG's preliminary views as expressed in the consultation paper:

a. **Role of stewardship in the ED**. Even though we acknowledge the concerns that stewardship has not been given adequate prominence in the ED, FEE does not agree that stewardship should be included as a separate objective of financial reporting for the same reasons as explained in the Basis for Conclusions (BC1.10) of the ED[1].

b. **Prudence.** FEE recognises that asymmetric prudence might be appropriate in certain circumstances but does not invite the IASB to introduce the concept within the Conceptual Framework. FEE is rather inviting the IASB to consider the notion of prudence more broadly, not just for measurement but also for recognition purposes. FEE also suggests recognising prudence separately from neutrality.

[1] The IASB rejected the idea of identifying the provision of information to help assess management stewardship as an additional objective of financial reporting for the following reasons:

- Information about management's stewardship is part of the information used to make decisions about whether to buy, sell or hold an investment
- Introducing an additional primary objective of financial reporting could be confusing.

c. **Substance over form.** FEE welcomes the introduction of substance over form as part of the faithful representation as included in the ED. Even though we acknowledge that legal form can affect directly the economic substance of the transactions, FEE does not believe that a direct reference to legal form is necessary in the Conceptual Framework.

d. **Definition of income and expenses.** FEE agrees with the IASB's proposals in the ED regarding the definitions of income and expenses.

e. **Executory contracts.** In our letter to the IASB we welcome the guidance on executory contracts, however we ask to further articulate the notion of unit of account and how the IASB intends to use this notion in the guidance for executory contracts in the Revised Conceptual Framework.

f. **Reporting items of income and expenses in the other comprehensive income**. In our comments to the IASB we agree with the notion that the profit or loss should be the primary source of information about an entity's financial performance for the period.

g. We do not agree with EFRAG's preliminary views on **long-term investors.**

**Summary of comments made to the IASB on its ED on the Conceptual Framework**[2]

**Financial reporting as a communication tool**

(4) FEE agrees with the discussion in the IASB's ED regarding the primary users. We believe that financial reporting should serve as a communication tool for the entity to communicate with its (primarily) external stakeholders. Having said this, we believe that internal users should also be recognised. In instances where this would lead to conflicting objectives, external (primary) users' objectives should take prominence over internal users' objectives.

**Reliability**

(5) FEE does not agree with EFRAG's comments on reliability and faithful representation. FEE believes that the notion of faithful representation is wider than reliability. In our detailed comments to the IASB we suggest that the IASB should introduce a discussion regarding reliability under faithful representation to address these concerns.

**Measurement Uncertainty**

(6) FEE agrees with the need to discuss uncertainty in the Conceptual Framework. However, FEE questions whether it is not too narrow to introduce this notion as part of relevance only as it is believed to equally apply to faithful representation. FEE would therefore suggest to the IASB to consider introducing uncertainty at large as an underlying constraint when discussing the qualitative characteristics and then elaborate further on existence and measurement uncertainty in the relevant chapters.

[2] We attach our detailed comments to the IASB where you may find more detailed comments on the positions expressed in this letter.

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**Reporting entity**

(7) FEE believes that the IASB should revisit this chapter and positively define the reporting entity. Even though we acknowledge that control is a key aspect; we also believe that it is debatable where the boundaries of the reporting entity should actually lie. Therefore we urge the IASB to revisit its guidance in the ED and define better the boundaries of the reporting entity.

**Elements of financial reporting**

(8) We broadly agree with the IASB's proposed definitions and approach for financial reporting. We support the proposed asset-liability approach and agree that only items that meet the definition of assets and liabilities should be included in the statement of financial position; however this should not be to the detriment of the relevance of the statement of financial performance and of the quality of financial reporting as a whole.

(9) We raised some concerns regarding potential inconsistencies due to the revised definition of liabilities. In our comments to the IASB we urge the board to conduct a more thorough research on these inconsistencies (especially inconsistencies with IAS 37). We believe that the analysis currently included in the ED is not complete and not sufficiently developed.

**Business activities and business model**

(10) FEE welcomes the revised guidance on business activities in the ED and we support the way that the IASB explains how the business activities affect the different steps in financial reporting.

(11) In our comments to the IASB we ask the Board to define business activities and if the intention of the Board is to use business activities in the same context as business model, then we propose to use the same terminology across the IFRS literature.

**Profit or loss and OCI**

(12) FEE expresses its support to EFRAG for asking further guidance on the use of profit or loss and the use of OCI. We agree that the use of OCI should be restricted only to the IASB and only for specific instances that enhance the usefulness of profit or loss.

(13) In our detailed comments to the IASB we ask for more clarity on the main principles for the use of the OCI and for some examples where the Board could consider the use of OCI in future standard setting activities.

(14) Albeit this recommendation, we recognise the efforts already made by the IASB to develop principles on the use of OCI, which have proven to be challenging. We therefore acknowledge that it might be more efficient to defer the development of such guidance to a separate project and to eventually update the Conceptual Framework based on the outcome of such project.

For further information on this letter, please contact Pantelis Pavlou, Manager from the FEE Team on +32 2 893 33 74 or via e-mail at pantelis.pavlou@fee.be.

Yours sincerely,

Petr Kriz

President

Olivier Boutellis-Taft

Chief Executive

Encl. Appendix – FEE response to EFRAG's specific questions included in its public consultation paper on the IASB's ED on the Conceptual Framework for Financial Reporting

Attached: FEE Comment letter to the IASB on the ED2015/3 Conceptual Framework for Financial Reporting

**Question (p8) – Chapter 1 and 2 Stewardship**

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.

(1) From a conceptual point of view accounting standards serve as a common language for financial information that prepares use to communicate with (mainly) external users. Using a high quality set of accounting standards reduces the need for Non-GAAP information. With this in mind, we refer to paragraphs 1.9 and 1.10 of the ED, which identify other users of financial reporting.

(2) FEE agrees with the discussion in the IASB's ED regarding the primary users. We believe that financial reporting should serve as a communication tool for the entity to communicate with its (primarily) external stakeholders. Having said this, we believe that internal users should also be recognised. In instances where this would lead to conflicting objectives, external (primary) users' objectives should take prominence over internal users' objectives.

**Question (p14) – Chapter 1 and 2 Faithful representation versus Reliability**

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?

(3) **FEE disagrees with EFRAG's suggestion.** We believe that reliability might be seen to relate to clerical accuracy while the qualitative characteristics of financial reporting should refer to a wider notion than just clerical accuracy.

(4) In its response to the IASB, FEE suggests to the IASB to add a discussion for reliability in the Revised Conceptual Framework to clarify that reliability is part of faithful representation (similar discussion as included in the Basis on Conclusions).

**Question (p16) - Chapter 3 Reporting Entity**

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.

(5) We agree with EFRAG and believe that it is more urgent to define how to identify the boundaries of the reporting entity in the ED. By positively defining the boundaries the IASB will have the opportunity to provide some more guidance for combined (and carve-out) financial statements.

**Question (p20) – Chapter 4 The Elements of Financial Statements:**

Do you agree with the view that the asset liability approach leads to more robust and consistent financial reporting than a pure matching approach? (Why/why not?)

(6) The ED, and the current Conceptual Framework, can be seen as taking an asset-liability approach. More emphasis on the definition and recognition of assets and liabilities is included compared to the definition and recognition of income and expenses (since income and expenses are defined as changes in the assets or liabilities other than the contribution to and from the owners).

(7) Even though we support the asset and liability approach as adopted by the current Framework and ED, this should not be to the detriment of the relevance of the statement of financial performance and of the quality of financial reporting as a whole.

(8) Therefore we agree with the discussion in paragraph 5.8, where the ED explains the IASB's intentions not to overlook the concept of matching of income and expense. We support the discussion around this matter and the clarification that this concept does not override the need for an element to meet to the definition of an asset or a liability to be recognised in the statement of financial position.

**Question (p22) – Chapter 4 Present obligation**

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.

Please provide input on this issue.

(9) Even though FEE has not conducted thorough research on all the aspects of the revised guidance on the present obligation we identified that IAS 37 (especially some of the specific examples in the standard) will not be in line with the proposed guidance in the Revised Conceptual Framework.

(10) FEE believes that the analysis in the Basis on Conclusions (section BCE) is not sufficiently developed. We believe that further inconsistencies might exist as a result of the revised Conceptual Framework; therefore we strongly suggest that the IASB undertake a thorough review and analysis of the possible effects of the revised guidance and in particular the guidance in IAS 37, especially based on the EFRAG survey.

**Question (p33) – Chapter 6 Selection of Measurement basis**

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?

(11) FEE supports the discussion in paragraph 6.54 of the ED. We agree with the two main factors identified in the Conceptual Framework (paragraph 6.54). The first factor refers to business activities. Without defining the term business activities, the IASB acknowledges that it is an important factor when selecting a measurement basis. We also agree with the second factor identified in the ED. For example, derivatives have specific characteristics that require a certain measurement basis in the financial statements, however when a financial instrument (e.g. a derivative) is held for the purpose of delivery of non-financial assets in accordance with expected usage , then those instruments are not subject to the same rules (IAS 39 paragraph 5).

**Question (p34) – Chapter 6 Measurement bases**

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?

(12) We agree with the proposals in the ED re the different measurement bases for financial position and profit or loss. The factors listed in paragraph 6.54 provide adequate guidance for the IASB to consider, when developing its future standards, whether to introduce different measurement bases or not. Additionally, the IASB should consider those factors when deciding which measurement basis should be introduced in a particular standard.

**Question (p37) – Chapter 7 Presentation and Disclosure**

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?

(13) We believe that the views expressed by two IASB members have their merits and need to be further explored by the IASB. We also make the link with the lack of guidance for cash flows in the ED. We believe that one factor that is relevant to the discussion about persistence and different predicting values is the way that income and expenses contribute to future cash flows.

**Question (p38-39) - Chapter 7 Items in Profit or Loss**

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 support 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?

(14) In principle, FEE agrees with the statement in paragraph AV2 stating that the IASB missed the opportunity to conceptually define the use of OCI and its role in depicting financial performance. However, we support IASB's initiative to undertake a separate project to work on financial performance and therefore we understand the Board's decision to proceed with the framework even though this chapter might be seen as insufficiently developed.

(15) We strongly agree with the view that lack of discipline regarding recycling might impair financial reporting in the future. In line with our comments to the IASB, we support the view that the Revised Conceptual Framework should always require reclassification of income and expenses initially recognised in the OCI to the profit or loss in subsequent periods if the cumulative result is not zero. We believe that the identification of an appropriate basis for recycling could be an important factor for the IASB to consider whether the use of the OCI is appropriate in the first place; however it may be appropriate to depart from the recycling principle on occasion (unlike the views stated in AV 7). We would expect the IASB to explain at a standards level why they have departed from the Revised Conceptual Framework if those instances were to occur.

(16) FEE agrees with the principle in paragraph AV6 where two IASB members support the need for introducing guidance when the OCI should be used. We believe that the main principle for the IASB to consider is included in paragraph 7.24 (b) of the ED, however the IASB should consider introducing further guidance/discipline on recycling. We would not be opposed to a discussion about the three concepts discussed in the question ('bridging items'; 'mismatched remeasurements' and 'transitory remeasurements'). In our response to the IASB we urge the IASB to add some examples to better clarify paragraph 7.24 (b).

**Question (p41) – Chapter 8 Concepts of Capital and Capital Maintenance**

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?

(17) We believe that the chapter on capital maintenance is neither well developed nor linked to the rest of the conceptual framework. We also note that the notion of Capital Maintenance is not widely used in the current IFRS literature. Therefore, FEE suggests to either providing more guidance on the capital maintenance principles, including the IASB's intentions on how this notion will be used in the future and how it impacts the other chapters of the Conceptual Framework, or to consider eliminating the chapter entirely from the Revised Conceptual Framework.

**Question (p42) – Other Issues: Effects of the proposed changes**

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?

(18) We agree with the status of the Conceptual Framework and that its revision will not necessarily mean an automatic change in the existing standards. However, in line with our previous comments, FEE suggests that the IASB adds to its agenda an overarching, longer-term project to review the existing standards as a result of the Revised Conceptual Framework.

**Question (p45) – Other Issues: Long-term investment**

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?

(19) FEE agrees with both statements. We support the IASB's conclusions not to distinguish between long-term and short term investors. We also support the conclusions of the Board re the primary users, their information needs and the objective of the general purpose financial reporting.

**Question (p46) – Ideas included in the Discussion Paper**

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?

(20) In line with our comments to the IASB, we believe that a discussion on the business model and how it affects financial reporting should be included in the Revised Conceptual Framework. The ED refers at several occasions to business activities; however it is not clear whether the IASB refers to business activities in the same context as business models. If this is the case, then we suggest to the IASB to use consistent terminology across the IFRS literature and to use the term "business model" as it has already been used in IFRS 9. Being consistent reduces the risks of misinterpretation and confusion among constituents.

(21) In line with our comments in our letter to the IASB, we support two board members' alternative views re the distinction between liabilities and equity[3]. We believe that the Revised Conceptual Framework should at least provide some high level guidance on this matter and then be updated once the dedicated project: "Financial instruments with Characteristic of Equity (FICE)" is finalised. Having said that, we also support the IASB's view that the Conceptual Framework project should not be unduly delayed due to other ongoing projects. Therefore, we would suggest that the IASB revisits its Revised Conceptual Framework as a living document, as soon as it finalises the FICE project to add some conceptual discussion re the distinction between liability and equity.

[3] Two IASB members voted against the publication of the ED because they disagree with the changes proposed to the definition of a liability. Even though they agree that the definition of a liability should be used to distinguish between liability and equity, they believe that the IASB should have more fully considered changes to the definition of a liability to address the classification of claims against the entity as liability or equity.