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IASB
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Response to IASB: DP/2013/1

A Review of the Conceptual Framework for Financial Reporting

The Financial Reporting and Analysis Committee (FRAC) of the CFA Society of the UK (CFA UK) welcomes the opportunity to respond to the International Accounting Standards Board (IASB) discussion paper 'A Review of the Conceptual Framework for Financial Reporting'.

CFA UK represents more than 10,000 investment professionals working across the financial sector. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

Executive Summary

Section 1 Introduction

The FRAC broadly agrees with the primary purpose, but sees a stronger role for the Conceptual Framework in setting the principles that underpin the standards and aid understanding of them.

We have commented on paragraph 1.35 even though there is no question on it. This is because the list of things that "users find useful" is incomplete. Users wish to forecast future cash flows and that is based on analysis of operating performance, as well as changes in balance sheet values.

Section 2 Elements of financial statements

The definition "capable" of producing economic benefits seems too broad for recognition purposes. It may, however, help determine which items should be disclosed when their value is uncertain.[1] Users wish to see potential, material gains/losses disclosed even if the amounts are uncertain. While the concepts of relevance and faithful representation are crucial in narrowing the definition for recognition purposes, it is difficult to envisage no role for probability in tackling uncertainty.

As supporters of neutrality, we do not agree that there should be a higher threshold for recognising assets than liabilities. We do, however, see the need for "exercising a degree of caution in conditions of uncertainty". It must be clear that "caution" does not imply a conservative bias.

[1] In this comment letter, references to 'recognition' and 'presentation' relate to their appearance on the primary financial statements. References to 'disclosure' relate to note disclosures.

We believe it would be helpful for the CF to identify elements of profit or loss (P/L), other comprehensive income (OCI) and cash flow, as it does for the balance sheet. We note proposals to improve the statement of changes in equity. The CF should set out guiding principles ahead of the planned and welcome return to the financial statement presentation project.

Section 3 Additional guidance to support the asset and liability definitions
On "present" obligations, we prefer View 2 for recognition purposes, with View 3 triggering disclosure. This is not a majority opinion – View 3 has some support.

Section 4 Recognition and derecognition
On recognition, we broadly agree with the reasons for not recognising an asset, although a minority view is that the existence and, to the extent practical, value of internally generated intangible assets should at least be disclosed.

On faithful representation, enhancing characteristics and substance over form: we believe it would be helpful to include, in Chapter 3, the following sentence from the basis for conclusions for the 2010 Framework: "Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation." This would underpin the recognition/derecognition criteria.

We believe it is desirable for the control and risks/rewards approaches to work together (like the control model in IFRS 10), perhaps through a risks/rewards test if the seller has a continuing involvement.

Section 5 Definition of equity and distinction between liabilities and equity instruments
A key concern for equity investors is potential dilution through additional equity issuance, so this must at least be clearly disclosed. Under the strict obligation approach, we are wary of something that looks like a cost going straight to equity. So we find the advantages of the narrow equity approach more compelling.

Section 6 Measurement
Under the objective, we would we would like a separate point to be added that refers to the need to help users forecast future cash flows.

The aim should be to use the most appropriate measure, and the merits of various valuation techniques are listed here. While any opportunity to rationalise and standardise the menu should be taken, in practice, using the most appropriate measure appears to outweigh limiting the number. There are opportunities to read across from the work on fair/current value measurement in IFRS 13. To aid consistency in cash-flow-based measurement, the guidance from 6.111 onwards provides a good basis.

On the entity perspective, we have some reservations about the subjectivity of the business model approach and its impact on comparability. We are also wary of allowing sector-based exemptions. As far as possible, similar assets/liabilities should be measured in the same way.

Section 7 Presentation and disclosure
We are not as concerned as others about the length and complexity of financial reports.

We do not think that Financial Statement Presentation is simply a disclosure issue. "Presentation" is more important – see response to Section 2.

The IASB is right to stick to a user-focused principle for materiality. Similarly, communication principles should be very concise in the CF, with further guidance elsewhere.

Section 8 Presentation in the statement of comprehensive Income – profit or loss and other comprehensive income
We have commented on paragraphs 8.1-18 even though there is no question on them. The main points are:

- If the P/L is the primary performance indicator, its main components should be defined. It is not enough to describe it as the "default" category. The proliferation of non-GAAP measures is partly due to a lack of definition of operating performance.
- Where operating, or transaction-based, gains and losses are muddled up with, or treated as equivalent to, remeasurements, it makes it more difficult to predict future cash flows. Better guidance is needed on the sub-totals that make up total comprehensive income.
- A balance sheet-orientated approach to performance is less relevant to the growing number of companies that generate intangible value internally, which is not captured on the balance sheet. We would like the IASB to pay more attention to the needs of users of accounts who rely more heavily on the income and cash flow statements of such companies.
- The DP covers remeasurements that go through OCI but users are also concerned about remeasurements within the P/L, giving rise to unrealised gains and losses that may or may not recur.

On items permitted in OCI: we support approach 2B, and overall the approach to recycling. While the use of OCI should be strictly limited, the DP provides a logical basis for putting some gains/losses there. However, if the original measurement results in a number that is not regarded as relevant, maybe the first question should be: should the accounting be changed?

Mismatches is the easiest of the three to agree with.

Bridging: ideally items would be treated in the same way in all the financial statements, with disclosure of other relevant information in the notes. We have questioned some of the uses so far.

Transitory remeasurements: we agree with the logic for defined benefit pensions. The concern is that this option will open the door to other uncomfortable, volatile numbers being classed as transitory when the volatility is a relevant performance indicator, or the change is not reversed.

Section 9 Other Issues
Chapters 1 and 3:
Stewardship is adequately covered in the existing CF. To tackle the concerns raised by some, it may be worth adding a reference to management accountability.

Prudence: We are supporters of neutrality in accounting. This means free from bias and many people regard "prudence" as having a conservative bias. A CFA UK survey found that nearly half of respondents would expect to adjust for a conservative bias in financial information if "prudence" were a fundamental characteristic.
We support the idea that "a degree of caution" should be exercised in "conditions of uncertainty". The word "caution" should not imply a conservative bias. Management bias is clearly not neutral and should be leaned against by auditors and independent directors.

Faithful representation: In the CFA UK survey, members voted more than two to one in favour of faithful representation, rather than prudence, as a fundamental characteristic of financial reporting. The wording of Chapter 3 could be improved to emphasise that faithful representation is intended to capture the underlying economic reality of a company's financial position and performance.

Reliability: Because this term might imply that a number is sustainable over time, we do not think it would be helpful to reinstate this concept. Users should be aware that the numbers are the best estimates for the date in the accounts, and realise the inherent limitations.

Business model
We are wary of the IASB routinely adopting a business model approach in setting standards. Giving management more flexibility increases subjectivity in accounts and reduces comparability. As far as possible, measurement should be linked to the intrinsic characteristics of the underlying assets and liabilities and similar assets and liabilities should be accounted for in the same way.

Main response

SECTION 1—INTRODUCTION P15-21

Q1. Do you agree with [the following] preliminary views? Why or why not? 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;
Broadly, yes. But this may underplay the importance of the Conceptual Framework (CF) to preparers, auditors and users in understanding the principles that underpin the standards. The framework sets out the spirit in which standards should be interpreted and implemented.
The CF should drive, not just 'assist' in choosing, the accounting principles used by the IASB in drafting standards.

(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 [it], in the Basis for Conclusions on that Standard.
Since the CF sets underlying principles, in an ideal world there would be no conflict. If,

for practical purposes, rare exceptions arise, they should prompt the IASB to consider whether the accounting resulting from the exception is justified. Any exceptions should be temporary and the IASB should seek a way to eliminate them.

There is no formal question on par 1.35, but it is important because it sets out the objective of financial reporting. The FRAC has the following comments on 1.35(b):

i) This list seems very balance sheet orientated. It should be improved to better reflect what "users find useful". In particular their objective is to forecast future cash flows and to hold the management to account for operating performance, as well as for changes in the value of assets/liabilities. (See response to Section 8.)

ii) We believe point (iv) encapsulates the stewardship concept without mentioning the word. To respond to concern on this matter, we would not oppose an addition, or footnote, along the lines of: "also referred to as management accountability (or stewardship)". The FRAC finds the word accountability much more helpful than stewardship in an international context.

SECTION 2—ELEMENTS OF FINANCIAL STATEMENTS P22-36

Definitions of assets and liabilities
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?

We are wary of broadening the definitions for recognition purposes. It sounds as though significantly more assets and liabilities may be recognised. Ultimately what matters to users is cash flows and some committee members feel the existing definition, retaining a probability element, better allows users to forecast them. It is not clear that the concepts of relevance and faithful representation will provide a sufficient recognition threshold.
A related reason for wariness about the word "capability" is that an element of deliverability (of a benefit) should be required for an asset to be recognised, otherwise the item is more an opportunity than an asset. We would be uncomfortable with management booking an "opportunity" on the balance sheet simply because the entity is "capable" of producing economic benefits as a result of that opportunity.

However, if the definition has to be met in order to trigger a disclosure (rather than recognition on the balance sheet), then being "capable" of enhancing or depleting resources is a helpful concept. Users want to be informed of a company's risk outlook, including contingent assets/liabilities and other potential in/out flows that may be material but are difficult to measure. If capability is the broad definition, the narrower test applied to recognition needs to be clarified (see responses to Section 4). It is difficult to envisage no role for probability in this.

A separate point is that if the purpose is to expand the definition, this makes it more surprising that internally generated intangible assets remain excluded – although this does demonstrate the "too difficult to measure" limit in practice.

Role of uncertainty
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 pars 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?

If capability is the broad definition, the stricter test applied to recognition needs to be clarified (see response to Section 4).

It is difficult to reconcile the phrase that inflows/outflows "need not be certain" with the concept that the value attached must be relevant and a faithful representation. The key observation comes in 2.35 – "Nevertheless, uncertainty may make some rights or obligations so difficult to measure that recognising them might result in information that is not relevant". If assets/liabilities do not meet the recognition criteria, but are material to users of accounts, the assumption should be that they are disclosed in the notes, perhaps with a range of potential outcomes.
If they are recognised, despite some uncertainty, it seems difficult to get away from the concept of probability.

We do not agree with the view of some (par 2.27 and 2.28) that there should be a higher threshold for recognising assets than liabilities. This approach is not neutral. We do, however, agree with 2.28(b) for both assets and liabilities: "exercising a degree of caution in conditions of uncertainty would counter any conscious or subconscious bias of management towards optimism". It should be clear that the word "caution" does not imply a conservative bias.
The issue of reporting on potential liabilities that cannot yet be measured with any certainty is better dealt with in risk reports and in notes eg on exposures and contingent liabilities. This also takes care of situations, such as in lawsuits, where the outcome is binary (eg a fine or not) and so a probability-weighted answer is not appropriate.

Rather than leaving it to the standards-development stage, the CF should provide guidance for recognition that is more concrete than "capable". A first step might be to stipulate that the item can be measured in a way that satisfies the concepts of relevance and faithful representation. This is in line with Section 4. A second step would be to consider whether probability might still be a relevant indicator in the recognition decision.

Definitions of income and expense
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?
Yes it would be helpful. We broadly agree with the view expressed in 2.42. We would like to see a revision of the existing CF's stance, as described in par 2.45. We note, from par 2.46, that these issues may be taken care of in a review of standards on financial statement presentation, which we would welcome. But the guiding principles should be set out in the CF. This would entail distinguishing between operating activities – transactions, in/outflows – and changes in valuations. Revaluation gains/losses, along with profits/losses on disposals, should be disaggregated.

Many users focus on forecasting recurring operating cash flows, especially in analysing companies where the balance sheet does not provide a full reflection of "economic resources" (such as those with internally generated intangible assets).

The CFA Institute and the UK Society have consistently called for improvements in the cash flow statement, following as direct an approach as possible.

We agree with the following sentence in par 2.52 – "It may be helpful for it [the IASB] to define elements for each primary financial statement" and note that the IASB at least "does not foresee great difficulties in developing definitions" for the statement of cash flow.

We note that chapter 5 proposes some improvements to the statement of changes in equity. While these may have merit, we have not heard calls from members for this to be a priority, whereas they have done so for the comprehensive income and cash flow statements.

SECTION 3—ADDITIONAL GUIDANCE TO SUPPORT THE ASSET AND LIABILITY DEFINITIONS P37-66

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?
Agree.

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.
We agree with the rejection of View 1. View 2 does create a present obligation, so that makes sense as a guideline.

View 3 – we believe that the potential outflow, assuming it is material, must be disclosed in the notes. For a lawsuit, where the outflow is conditional on a finding of guilt and/or unpredictable penalties or compensation, we would prefer disclosure of the claim or case but not formal recognition and measurement of a forecast outcome. It is not in shareholders' interests for a company prematurely to allow for costs that it is disputing, and where their size is too uncertain to justify a balance sheet figure.
Consider the following scenario. A company has an obligation and is required to make a payment that is virtually certain in amount and imminent, assuming the company remains a going concern. So a portion of the liability might be recognised on an accrual accounting basis. Presumably a probability-weighted calculation of the "virtually certain" portion of the obligation would be needed. But looked at from a payment due/asset perspective, this would seem to go against the principle in the revenue recognition standard that you wait until control has passed from one party to another (rather than booking early on a percentage-of-completion basis). Assuming View 2 covers the recognition of imminent payments by a going concern, disclosure of other likely and material in/out flows would be sufficient.
Therefore, it seems that View 2 could provide the recognition criteria, while View 3 could cover items that are capable of creating an economic benefit, but where recognition would be either premature or the amount too uncertain to be faithfully represented in one number. This group of contingent, and other constructive or anticipated assets/liabilities, should be disclosed with value ranges where relevant.

Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?
If the number in the balance sheet is particularly sensitive to changes in key assumptions, disclosures on the range of potential outcomes should include low-probability but potentially high-impact scenarios*.*

SECTION 4—RECOGNITION AND DERECOGNITION P67-83
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?
Broadly agree. A minority view is that the existence and, to the extent practical, value of internally generated intangible assets should at least be disclosed, since they often drive value and it is inconsistent to measure acquired goodwill but not internally generated. The majority of the FRAC agree, however, that it is too difficult to arrive at a faithful representation of goodwill outside a transaction. Users believe it is their job to value the company and that its market price provides a valuation. This is in line with the statement: "Financial statements are not designed to show the value of a reporting entity". As Chapter 1 of the existing CF says, the statements "provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity."

"Faithful representation" and related enhancing characteristics:
As in the response to question 3, we note that the pre-2010 CF referred to the need for "a degree of caution" when making estimates under conditions of uncertainty. This is reflected in a number of accounting standards, but is no longer explicit in chapter 3. The FRAC has no objection to an amplification tackling some of the concerns that have been expressed, but it does not support any change that allows a conservative bias. (See also the response to question 22.)
The basis for conclusions for the 2010 Framework stated that "substance over form" was a redundant phrase because: "Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation." The FRAC thinks it would be helpful to include this sentence, or something similar, in chapter 3.

4.22: Where "A range of possible amounts and the related probabilities can also be verified", we believe disclosure of the range would be better than providing no information. So 4.26(a) and 4.27 are more in line with our views than 4.26(b).
One point that needs clarification in 4.26(b) is: "if an asset (or a liability) exists, but there is only a low probability that an inflow (or outflow) of economic benefits will result". This appears to contradict earlier statements about deleting references to probability.

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?

In previous submissions we have expressed regret at the omission of the risk/reward approach. While we find the control approach central to the recognition/derecognition issue, we also think the approach described in 4.36 (b) is helpful, and so is the partial derecognition approach in 4.45 (b).

We note that in the Basis for Conclusions (BC32) for IFRS 10 Consolidated Financial Statements, the IASB states: "that exposure to risks and rewards is an indicator of control and an important factor to consider when assessing control". We believe it is a crucial factor in derecognition, so it would be desirable to make the two approaches work together.

A combined approach might be control with a risks/rewards overlay i.e. if the seller has any continuing involvement, apply a risks/rewards test, for instance in a repo transaction.

Section 5—Definition of equity and distinction between liabilities and equity instruments P84-105

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 CF should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.

(b) the CF 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 par 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?
While the FRAC is less interested in the statement of changes in equity than in the other financial statements, we may find an enhanced statement more useful. A key concern for equity investors is potential dilution through additional equity issuance. So whatever approach is adopted, potential dilution must at least be clearly disclosed. We are sympathetic to the advantages of the narrow equity approach set out in par 5.36.

There is clearly a difference between hybrids, eg convertible bonds (including contingent convertibles) that look like debt unless and until they convert, and equity instruments such as options that either turn into equity or lapse. 5.37 (b) (i) takes care of that and is consistent with a narrow equity approach. For equity claims, covered in (b) (ii), there are established pricing models and measurement techniques for equity instruments, allowing a relevant and faithful representation of the obligation to be arrived at. So we prefer the narrow equity approach of classifying prior claims as liabilities and are wary of something that looks like a cost going straight to equity, which would give that cost less prominence. Would the strict obligation approach move us backwards on the issue of recognising employee share options as a cost, for instance?

Section 6—Measurement p106-134
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.**
> Agree, although we would like a separate point to be added that refers to the need to help users forecast future cash flows.

(b)a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
Agree

(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;
Agree

(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.**
> We have a few reservations about this because it may allow unnecessary subjectivity and inconsistency in the measurement of similar assets and liabilities.

Are investors, creditors and other lenders the same as the concept of market participants in fair value measurement? We would be wary of opening the door to allowing management to select a measure because they deem it to be consistent with the entity's 'business model'.

(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

We agree with the second sentence.

On the first, there is a crucial difference between choosing the most appropriate valuation technique at the outset, with which we agree, and having the latitude to change it later, which should be very strictly limited. 6.23 does not make this distinction.

A number of appropriate valuation techniques are set out in 6.38-6.52, including cash-flow-based and replacement cost methods. It is easier to understand the application of the most appropriate measure than the shoe-horning of an asset/liability into a less appropriate regime.

Pars 6.38-6.52 (and IFRS 13) set out a menu of techniques for cost-based, current market and other cash-flow-based measures. There is overlap between these measures eg through cash-flow calculations for impairment on the cost-based side and the replacement cost approach to fair/current value. So sticking to a two-measurement (FV and cost) model may not be as limiting as it seems. But this needs clarification.

The merits of various techniques are listed here and included in IFRS 13. While any opportunity to rationalise the menu should be taken, it is not surprising that there has been a tendency to expand it eg in the proposals for insurance contracts. So, in practice, using the most appropriate measure appears to outweigh limiting the number of techniques.

(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Agree, with the proviso that preparers will often exaggerate the cost. Therefore, if something users view as an improvement is to be blocked, the cost must be clearly excessive.

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?

The main points are that the lessons learnt from work on fair/current value measurement, notably IFRS 13 on valuation techniques, should be applied; and that the overlap between updated cost and fair/current value techniques may be more relevant than the following distinction drawn in par 6.51: "A few measurements used in existing IFRSs are neither current market prices nor cost-based, but are based on estimates of future cash flows."

We note that IFRS 13 contains significant guidance on using future cash flows to estimate fair value.

So the more eclectic approach of par 6.58, which mentions three broad measurement approaches, makes sense.

Other smaller points:

Faithful representation, par 6.21 sounds process driven. The relevance criterion and the impact of uncertainty may mean that disclosure eg of a range is more useful than the false precision of a number that is correctly calculated on the basis of questionable inputs to a

model.
We have some sympathy with the following in par 6.34: "Some argue that when the subjectivity of a particular measurement is very high, the measurement cannot be a faithful representation." However, as noted elsewhere in this response, we prefer disclosure of this information even when the item is not recognised.

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.**
Agree

(b) **if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.**
Agree

(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.**
Agree

(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.**
We have some reservations about the subjectivity of the business model approach and its impact on comparability. We are also wary of allowing sector-based exemptions. As far as possible, similar assets/liabilities should be measured in the same way. We have a question about par 6.75(a): Is the IASB committed to regular use of a business model approach? This is not the impression given in section 9, pars 9.23-34. See response to Question 23.
We agree with pars 6.94-95, where the issue is less one of business model and more to do with the scale of the asset within the business – ie relevance and materiality are crucial.

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.

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.**
The example of legal violations raises the point that the outcome may be binary, or very uncertain, so no measurement can faithfully represent a likely outcome. Contingent liabilities (the ones that cannot be reliably measured) should be disclosed in the notes.

(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).

Agree with this and par 6.105 ie that current price information may be useful, via disclosure, even if the primary measurement approach is cost-based. It may be necessary to be more explicit about what is in 'cost' because different entities calculate it in different ways.

(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

If current market prices are available. Once the transfer has taken place, there would presumably be a transaction price. But a desire to transfer does not necessarily mean that the liability can be marked to market. In that case, a cost or cash-flow-based approach might be more appropriate. This would be in line with the hierarchy (Levels 1-3) in fair value measurement.

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.

Partially agree, although see caveats outlined above. Since we prefer an eclectic approach to measurement, the guidance from 6.111 onwards provides a good base for cash-flow measurements that would aid consistency.

Entity or market perspective? The least subjective measure should be used, so that wherever possible similar liabilities are measured in the same way. This aids verifiability and comparisons with other entities. However, there are fewer markets for liabilities than for assets, and so cash-flow-based measures may be the most appropriate. We broadly agree with 6.125-127.

The general principle should be, as far as possible, to require observable, or externally verifiable, inputs. Any entity-specific internal inputs should be detailed in the notes (assumptions and techniques used; sensitivities and stressed valuations; changes in assumptions from last reporting period, with rationale; etc).

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 (ie the asset or the liability is highly leveraged).

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

Agree for derivatives. For assets held for collection, where amortised cost does not work (not sure why it would not in (a)), then either a market price – if the market is liquid – or a cash-flow-based measure would be appropriate. Whether you start with hold-to-collect assets with anomalous cost and cash-flow characteristics, or trading assets that cannot be sold, there would seem to be scope for reading across from IFRS 13 on Level 3 assets and the guidance on the use of valuation techniques.

Question 15
Do you have any further comments on the discussion of measurement in this section?
6.112 (b) – "time value of money" raises the important question of discount rates. If the IASB is trying to standardise cash-flow-based measures, this is an area where more guidance might be needed. We support the research project currently underway in this area.

Section 7—Presentation and disclosure P135-149
We are not as concerned as others about the length and complexity of financial reports. (See CFAI paper, July 2013, on "Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume").

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 CF, which is to assist the IASB in developing and revising Standards; and
(b) other work that the IASB intends to undertake in the area of disclosure (see pars 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 Financial Statement Presentation;**
> We do not think that Financial Statement Presentation is simply a disclosure issue. "Presentation" of the primary financial statements is extremely important and it would have been better to have tackled the issues in Section 2 on elements of the financial statements. (See our response to Question 4.) Returning to the FSP project should be a priority, and we would prefer it if the CF included definitions and other guidance to underpin that work.
> **(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.

The proposals in (a) and (b) are uncontroversial. The text included in the CF should be as concise as possible, with more detailed guidance elsewhere.

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?

Agree. The IASB is right to stick to a user-focused principle for materiality. Better application of this concept would help to make the accounts more relevant.

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?

The principles are uncontroversial but in their present form they may clutter the CF. As with materiality, it might be better to have very concise principles, with further guidance elsewhere.

Section 8—Presentation in the statement of comprehensive income—profit or loss and other comprehensive income P150-180

There is no question on 8.1-18. Nevertheless, we would like to make the following comments:

We agree with the view in 8.3 that reporting of financial performance should be a priority topic. We share most of the concerns expressed in (a)-(d) but our reasons would have the following emphasis:

i) the proliferation of non-GAAP measures, eg "adjusted earnings", indicates a lack of definition in the standards of operating performance, which leads to a lack of discipline in the way companies report. If the P/L is the primary performance indicator, its main components should be defined. It is not enough to describe it as the "default" category.

ii) Where operating, or transaction-based, gains and losses are muddled up with, or treated as equivalent to, remeasurements, it makes it more difficult to predict future cash flows. Analysts are seeking a platform in the P/L on which to base their forecasts.

iii) The two perspectives – operating performance during the period and changes in the value of assets/liabilities – are both important. But they are not necessarily linked and it is helpful if they can be analysed separately. Total comprehensive income brings them together, as stated in 8.9, but better guidance is needed on the sub-totals that comprise it.

iv) A balance sheet-orientated approach to performance is most relevant to entities, such as banks, insurers, property companies, where net assets is a meaningful number – because most assets and liabilities are measured. But an increasing number of companies – in technology and media, for instance – generate intangible value that is not captured on the balance sheet. So it would be helpful if the IASB paid more attention to the needs of users who invest in/analyse these companies. They are particularly dependent on the operating and financing sections of the P/L, the cash flow statement, related notes and reconciliations to balance sheet numbers such as net debt.

8.8 There is a gap in the analysis between the amounts listed as included in the P/L: "cost-based measurements and most realised gains and losses" and the unrealised gains and losses, resulting from remeasurement, that go in OCI. Users are also concerned about remeasurements within the P/L, which give rise to unrealised gains and losses that may or may not recur. There is a starting point in the basis for conclusions of IFRS 13 (adapted from BC198):
"Realised gains or losses result from the sale, disposal or settlement of an asset or a liability, and therefore the asset or liability is no longer held by the entity at the reporting date. Unrealised gains or losses relate to changes in the fair value of an asset or a liability that is held by the entity at the reporting date."
This calls for more attention to definitions and disaggregation of line items, or columns, within the P/L, as was happening in the previous financial statement presentation project. Another reason for users sometimes finding a lack of relevance in the periodic balance sheet approach is that they are more interested in the total return on a transaction/investment than in changes in FV between two snapshot dates.
This is an issue for the notes to the accounts that a revived FSP could look at (and it comes up in the review of IFRS 3 Business Combinations).

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?
Agree but we believe there is scope for other sub-totals that would help users forecast future cash flows. This would bring some order to the proliferation of non-GAAP measures of operating and adjusted earnings. While non-GAAP measures are useful, they should be seen as a supplement, not an alternative, to IFRS numbers.
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 revising particular Standards?

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 recognized subsequently in profit or loss, ie 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?

Agree, and we do not think that all items should be recycled.
The P/L is still the primary performance statement for investors, therefore recycling of OCI items through P/L is an important matter. As an underlying principle, all OCI items that are eventually realised through an external transaction should be recycled through the P/L.

Question 21
In this DP, 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 DP.
We support 2B.
We believe that the use of OCI should be strictly limited. The DP provides a logical basis for putting some gains/losses there rather than in the P/L.
There is some overlap between the three groups – timing mismatches seem to be a common factor – so is there scope for an overall principle?
If the original measurement (leading to hybrid treatment) results in a number that is not regarded as relevant, maybe the first question should be: should the accounting (recognition and/or measurement) be changed?

Mismatches is the easiest of the three to agree with.

On bridging, the caveat is that ideally items would be treated in the same way in all the financial statements. For instance, we did not support the revival of an "available for sale" category in IFRS 9 using this approach. We would lean further towards 8.58(b): "recognising the results of one measure in the primary financial statements with disclosure of the other measure in the notes".

On the proposed new category, transitory remeasurements, we agree with the logic for defined benefit pensions (although again a question could be asked about the accounting if it leads to irrelevant volatility). The concern is that this option will open the door to other uncomfortable, volatile numbers being classed as transitory when either the volatility is a relevant performance indicator, or the change turns out not to be transitory. "Long term" would have to be strictly defined, and the level of balance-sheet volatility monitored. The number of items allowed to be fair valued through OCI without recycling should be kept to a minimum, and detailed disclosures should be provided to users.

We are mindful that numbers in OCI seem to be more often negative than positive; and that the financial statement data models of data aggregators do not reflect OCI items (the main exception to this is for banks).

Section 9—Other issues P-181-194

Question 22 - Chapters 1 and 3 of the existing Conceptual Framework
Pars 9.2–9.22 address the chapters of the existing CF 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 CF 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.

Stewardship: We believe the existing CF encapsulates the stewardship concept in OB 4 without mentioning the word. To respond to concern on this matter, we would not oppose an addition, or footnote, along the lines of: "also referred to as management accountability (or stewardship)". The FRAC finds the word accountability much more helpful than "stewardship" in an international context**.**

Prudence: We are supporters of neutrality in accounting. This means free from bias and many people regard "prudence" as having a conservative bias.
A CFA UK survey found that nearly half of respondents would expect to adjust for a conservative bias in financial information if "prudence" were a fundamental characteristic: 47.1% of respondents said yes, 35% no and 17.8% don't know.
The "yes" vote supports the FRAC's view. The split demonstrates confusion over whether prudence implies a conservative bias or not, giving a further reason not to support its reinstatement.
In answers to questions 3 and 8, we support the idea that "a degree of caution" should be exercised in "conditions of uncertainty". It should be clear, however, that the word "caution" does not imply a conservative bias.
As for any "bias of management towards optimism", that breaches the concept of neutrality and should, of course, be leaned against by auditors and independent directors. Users of accounts are aware of the potential for bias and can discount for it. More generally, we know that many numbers in the accounts involve estimates and judgments. It is simplest to assume that the aim has been to arrive at the most credible and robust estimate under the circumstances. We like to see this verified and to have assumptions disclosed, which reveals inevitable subjectivity. To add another layer of subjectivity through a bias towards conservatism, which would be impossible to quantify consistently, would further detract from the credibility of the numbers, which are supposed to reflect the underlying economic reality of a company's financial position and performance.

Faithful representation: The CFA UK survey asked: "Would you prefer to see 'prudence' or 'faithful representation' recognised as a fundamental characteristic of financial information?"
63.9% voted for faithful representation, 27.8% for prudence and 8.2% said don't know. This gives strong support to the FRAC's stance.
We believe that faithful representation captures the aim of reflecting the underlying economic reality. We would support the idea of making this more explicit. This could be done by including in Chapter 3 a sentence from the basis for conclusions for the 2010 Framework, which says: "Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation."
Stressing the economic substance is important because the definition of "free from error", as described in par 6.21, sounds rather process driven.

We discussed whether reinstating the concept of **reliability** would be helpful, but decided that it might imply a degree of sustainability over time that is misleading for a measurement at the balance sheet date. Users should be aware that the numbers are estimates about the value of the item at the date in the accounts. As soon as economic conditions and/or market prices change, so will many of the numbers.

Users should be aware of the limitations of apparently precise numbers that involve estimates, judgments and models, and of the time sensitive nature of the more easily verified numbers. It is up to them to be prudent (in the sense of wise) in deciding how to allocate capital on the basis of accounting and much other information.

Question 23 - Business model
The business model concept is discussed in paragraphs 9.23–9.34. This DP 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?
Entity specific information is obviously of great interest to users: no two sets of accounts are the same. Management commentary provides much entity-specific detail, including non-GAAP numbers, which users may find helpful. However, we are wary of the IASB routinely adopting a business model approach in setting standards.

Accounting standards are an antidote to the propensity of companies to prepare disparate accounts. They minimise management subjectivity and enhance consistency over time and comparability across companies. We do not support sector-specific standards, although some standards eg IFRS 9 and IFRS 4 clearly have more relevance for some sectors than others. As far as possible, measurement should be linked to the intrinsic characteristics of the underlying assets and liabilities.

More specifically, allowing management flexibility to measure assets or liabilities based on their business model is vulnerable to manipulation. Managements already make extensive use of opportunities to present measures that they claim better represent the company's business model and performance. The PIR of IFRS 8 showed that users had serious concerns about the business model approach to segment reporting, either because of insufficient disaggregation or because the segments changed too often in practice. These issues might indicate a need for more standardisation, not less.

Users of accounts like to have the two perspectives: through the eyes of management and the more objective statutory, audited accounts. Gaps between the two help us to hold management to account.

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?

Comments from two members:

Ideally the "unit of account" concept should be defined in the CF due to its potential impact across many significant accounting areas (recognition, measurement, classification) with a potential pervasive effect across all primary financial statements.

Furthermore, the unit of account has raised many questions in the application of IFRS 13 and could conceivably be raised for other measurements. The first question to answer when measuring an asset or liability is 'WHAT is it that is being measured?' To do that, one must know the unit of account. Because most standards do not specify it and companies are left determining it for themselves, and different audit firms have different interpretations of what the unit of account is for various assets and liabilities. This leads to some inconsistencies across company accounts. Any parameters the IASB can include on this important accounting concept would be useful from a practical application and comparability perspective.

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?

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 look forward to discussing the issues raised in this response.

Yours sincerely,

JFuller

Jane Fuller
Chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Will Goodhart,
Chief Executive
CFA Society of the UK

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