Notes from the Sydney (Tuesday 15 October), Melbourne (Friday 18 October) and Canberra (Monday 21 October 2013) Forums on IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*

General comments

IASB representatives explained that the DP focuses on areas that are troubling to the IASB in setting standards. So, the aim of the current IASB conceptual framework project is probably more limited than some constituents might expect.

One or more participants expressed the following views and observations.

* The IASB might have created an 'expectation gap' – that is, some constituents are looking for something much more fundamental and less focused on the thinking underlying existing IFRS and IFRS in the process of being developed. This should be carefully managed by the IASB.
* Once the current Conceptual Framework is finished, it will be a long time before another opportunity arises to revise it. Therefore, every effort should be made now to make it as robust and helpful as possible for setting future IFRS.
* The conceptual framework needs to stand the test of time, and the IASB seems too willing to relegate some conceptual level issues to its standard-setting work. There is a danger that the IASB will emerge from this conceptual framework project with little to help it set consistent and useful standards.
* It's not clear how this project will help entities needing to use the conceptual framework to determine accounting policies in the absence of there being a standard relevant to their transaction (as per the IAS 8 hierarchy).

Elements

Asset and liability definitions

IASB representatives explained the Board's thinking on using 'control' in the definition rather than as a recognition criterion. It was noted that its absence from the definition and inclusion as a recognition criterion would mean that entities would have to identify a larger population of assets and liabilities; and would then need to spend a great deal of time determining if they control each of those assets and liabilities.

One or more participants raised the following points.

* Entities might acquire new rights associated with existing assets and the conceptual framework needs to also consider these situations (e.g. are they new assets, or part of an existing asset).
* The three identified 'Views' do not provide an appropriate framework for considering the nature of present obligations. In particular, there is a spectrum of possible views, and the identification of only these three is too narrow a focus.
* The line between an obligation and economic compulsion is unclear – the example of instruments with accelerating dividends was given.
* The relationship between 'constructive' obligations and economic compulsion needs to be clarified – some think the former is a subset of the latter.
* A reference to 'past event' in the definition of liability is unnecessary.

* We need to avoid asymmetric reporting, whereby liabilities are recognised when there's an obligating event – but assets must meet a higher recognition threshold. (In that regard, it was observed that adoption of View 1 ['strictly unconditional'] would result in greater symmetry between assets and liabilities.) – [in a public sector context, arguments against recognising social benefit obligations as liabilities are understandable if, for example, a government's concomitant right to tax cannot be recognised as an asset.]
* Adopting View 1 would result in financial statements that lack utility by, for example, effectively ignoring the going concern assumption. Therefore, View 2 ['practically unconditional'] provides a more common sense way of ensuring useful information about liabilities is presented to users.
* A 'hybrid' of View 1, being strictly unconditional items plus assets/liabilities critical to the entity being a going concern. However, some are concerned that this would lead to the recognition of items that relate to future activities.
* Governments sometimes perform work, such as a clean-up of a contaminated site, even though they are not legally obligated to do so. It's a matter of whether government is, in practical terms, in a position that it's expected to pay, even though there is no enforceable claim on the government.
* In terms of disaster relief, governments enter into formal or tacit agreements that the Commonwealth will help the states – the issue is whether the obligating event is entering into an agreement to come to the assistance of the states (for example, by refunding some of the states' costs) or a disaster itself.
* The existence of a contract is an important factor that means liability exists and therefore any uncertainty about outcome should be addressed in measurement.
* 'Unconditional' is too high a hurdle for liability recognition and View 1 would lead to users missing out on important information, such as the obligations due to arise based in part on past activities (such as levies and long-term incentive plans). View 1 takes a 'liquidation' view that is too narrow.
* View 2, that a present obligation must have arisen from past events and be practically unconditional, seems to incorporate a notion of probability. Adoption of a 'probable' recognition criterion might not be consistent with View 1.
* In economic terms, the liability that accrues over time has value that should be recognised, even if it is yet to achieve the point at which it becomes unconditional.
* The focus on 'conditionality' has detracted from the real issue, which is 'existence' of a present obligation.

Asset and liability recognition and de-recognition

One or more participants raised the following points.

* From an aspirational point of view, it might be best for the conceptual framework to support recognising as many assets and liabilities as possible and limitations could be introduced and justified at the standards level.
* The current problem with probability is really a unit of account issue.
* A binary approach to recognition (not necessarily 50/50 – it could be based on a 'more than remote' threshold) is supportable, as there would be insurmountable difficulties associated with finding assets and liabilities with small probabilities of becoming

‘actual’ assets and liabilities. Governments in particular are often ‘last resort’ providers of assistance and could have numerous liabilities that they would need to look out for. Recognising such assets and liabilities also has implications for understandability, for example the understandability of expected values determined using small probabilities.

* There is a need to avoid the situation where every contingency would give rise to liability recognition.
* Governments have many options open to them that might constitute assets, and it would seem wrong to fill the financial statements with ‘remote’ assets, because it would be misleading for users. A ‘more than remote’ threshold might also be too low.
* It seems intuitively wrong to recognise something that’s not likely to happen. Users are already familiar with the ‘probable’ recognition filter.
* Every obligation has a current value – and some might be material even if they are less than probable.
* In practice, there is a great deal of ‘packing’ and ‘un-packing’ of assets and liabilities through securitisation etc. It’s easy to get assets and liabilities off-balance sheet under the control model – the risks and rewards model is more nuanced and can catch more of these. The current requirements in standards seemed to work quite well in practice (for example, issues relating to continuing involvement were able to be resolved in practice) through the GFC. Therefore, if the IASB is to fundamentally change that approach through the Conceptual Framework, it should demonstrate the benefits of making such a change.
* The notion that you recognise something you control and de-recognise something that you no longer control doesn’t deal with the issue of what that ‘something’ is in the case of partial de-recognition.
* Recognition and de-recognition decisions need to be neutral or at least consistent, but the IASB’s strategy of dealing with issues at the standards level has the potential to give rise to a continued mix of thresholds. The Conceptual Framework should include some concepts that constrain the IASB from adopting ad hoc recognition/de-recognition criteria in different standards
* Fears that the absence of a probability criterion would mean entities having to identify remote risks are unfounded.
* For some financial instruments, probability of outflows might be extremely low, but change quickly, and therefore should not be ignored.
* Views on de-recognition are circumstantial to some degree. If an entity still has a right among a number of rights it has just relinquished, a partial de-recognition approach would make sense.
* There needs to be more in the conceptual framework about the unit of account to help guide standards-level decisions on de-recognition.
* The decision around full de-recognition versus partial de-recognition needs to be decided at the standards level because it depends on the type of asset or liability concerned – for example, physical assets versus financial instruments.

Equity/liability distinction

IASB representatives explained the DP focuses on treating some instruments that are currently regarded as liabilities might be better treated as items of equity that have particular rights and obligations associated with them, with a view to that providing users with more insights on those instruments.

Identifying equity

One or more participants raised the following points.

* It's not clear that current practice has failed – so question the need to re-address this distinction. In practice, many instruments are designed to be settled with either equity instruments or not – and users seem to understand them as liabilities.
* The greatest arbitrage between liability and equity classifications arises because of the impact on the income statement of outflows being either expenses or distributions.
* There is a growing appetite for information on the range of equity-type instruments on issue. Different users are focused on the different instruments they are exposed to, and they want information about their relative risks and returns associated with the instruments.
* Even though the IASB seems to think of equity in terms of 'instruments', this seems inappropriate given that it's a residual.
* In determining if an instrument is equity in nature, it is important to look at the potential drain on an entity's liquidity – that is, whether the holders demand particular payments from the entity.
* The DP does not adequately address the different types of instruments that would be affected by the approach being considered, such as convertible debt instruments.

Remeasuring components of equity

One or more participants raised the following points.

* Re-measuring part of equity means that you're re-measuring a residual of a residual, which seems a difficult process to justify.
* Given the mixed measurement models applying to assets and liabilities, the equity residual is already a relatively meaningless number.
* Not convinced that re-measuring components of equity is at all worthwhile because it seems to have little information value.
* Re-measurements of equity will just increase the clutter in the statement of changes in equity, and could potentially obscure the more relevant information.

Treatment of obligations to deliver shares

One or more participants raised the following points.

* Classifying obligations to deliver shares, where shares are used as 'currency', as equity seems to place too much emphasis on the manner of settlement rather than the existence of the obligation.
* Claims in terms of shares are just another claim – the fact that the claim will be settled in shares is not relevant in considering whether the claim is a liability. It is necessary to distinguish between identifying a liability and looking at how it will be settled.
* There does not seem to be a transfer of value when something is settled with equity instruments. This is consistent with the notion that we don't identify foregone inflows as liabilities.

* In relation to obligations to deliver own shares, the IASB should consider the implications of an entity foregoing cash inflows (and symmetry with recognising obligations for cash outflows as liabilities) by not otherwise issuing shares in exchange for cash and using that cash to settle a liability.
* There is a need to look at both the issuer and holder perspectives because some instruments are economically equity, but are treated as liabilities under IFRS.
* In a GFS context, in relation to in-kind settlements, it is presumed that all the relevant items are sold by one entity and that the recipient buys those things. Settlement in shares would be regarded as in-kind settlements.

Puttable instruments

One or more participants raised the following points.

* There needs to be some distinction between equity instruments that can be put back to the entity in a way that effectively reduces its size versus equity instruments that are traded in third-party markets.
* In relation to puttable instruments held by members of a cooperative, it is not appropriate for the conceptual framework to contemplate an exception to a principle. That is the realm of standards, and should be rationalised in each case.

Presentation and disclosure

General

One or more participants raised the following points.

* This IASB project provides a real opportunity to make a significant contribution to addressing major concerns about disclosure overload.
* The conceptual framework should be where the IASB questions the information needed (whether or not in the form of particular primary financial statements), rather than accepting the current statements as a given. The conceptual framework should not 'hard-wire' the primary financial statements at the standards level – there should be more flexibility.
* A 'funds statement' would be better than a cash flow statement.
* The cash flow statement is a key focus for users.
* There are no new principles identified to help determine whether something should be disclosed. A lack of principles in the DP would mean that the IASB has no basis for rationalising current and future disclosure requirements. Furthermore, it is inappropriate that 'common user needs' is not mentioned in the DP.
* If the IASB intends including disclosure principles in each IFRS, it should at least articulate a principle at the conceptual framework level that would provide a context for such standards-level principles.
* There is too much emphasis on predicting future cash flows – if that's the real focus, then it may be best to ask for cash flow forecasts. However, this would be accompanied by the problems of exposure to risks for governing bodies of entities providing forecasts.

* It would be good to reduce the size of the financial statements and provide links (including electronically) to the more detailed information. Many users (and directors) say they are confused by the financial statements.
* It would be very helpful if the IASB managed to change the compliance and 'boilerplate' mindsets that currently pervade reporting under IFRS. The extent of current IFRS disclosure requirements has the potential to bring into question the value of the accounting profession.
* Many of the disclosure overload issues would be solved if Australia embraced lodging financial information in XBRL.

Distinguishing P/L from OCI

* The DP does not explain the objective of the distinction between P/L and OCI – the attempt to identify key characteristics of items falling into each category is not based on principles, but just reflects current IFRS. There is a link between understanding OCI and the notion of capital that is adopted.
* The P/L versus OCI distinction should not be hard-wired into the conceptual framework. Instead, there should be principles for disaggregation, such that there might be many sub-totals.
* There is no conceptual understanding of OCI – it is just a 'grab bag' of what we don't want in profit or loss. If we don't know what OCI is, how can we determine what goes into it?
* The distinction is important in trying to explain to users those aspects of the business that drive profitability. This is particularly the case where ongoing income and fair value changes affect an entity's assets and liabilities.
* There may be benefit in considering whether the GFS transactions/other economic flows distinction would be a suitable basis for application in a GAAP context for distinguishing P/L from OCI.
* Having one income statement with all expenses and revenues might be best. The one statement could be accompanied by explanations from management about the significant aspects that have influenced those expenses and revenues in the period; and/or explanations of the 'underlying result' that the entity thinks best represents its performance. There was some debate about whether those explanations should or should not be part of the general purpose financial statements.
* There is little support for recycling at a conceptual level. Recycling is inconsistent with all the other aspects of the conceptual framework – so a rationale for its existence is needed if it is to be an ongoing feature of IFRS.
* Developing a principle for recycling based on the notions underlying current IFRS risks expanding the types of items presented in OCI and extending the use of recycling.
* Cash flow hedges are a stumbling block to removing recycling.
* There is a lack of rigour around what could, or could not, be recycled under the identified approaches; especially Approach 2B that includes 'transitory items'.
* A conceptual framework should fundamentally address the meaning of profit or loss.
* Some of the ideas in the earlier work undertaken by the IASB on performance (in the context of presentation) might be worth pursuing.

Other issues

One or more participants raised the following points.

* The unit of account issue needs to be considered in two different ways – one is in terms of presentation – the other is in terms of how measurement is affected. Sometimes the unit of account is created as a way to facilitate measurement. It should also be addressed to a limited extent at a conceptual level, leaving more specific issues to be addressed at a standards level within the context of the broad conceptual guidance.
* The gross versus net issue also needs to be dealt with in terms of the unit of account.

Measurement

IASB representatives explained the DP tries to limit the range of measurement bases that IASB would look at in setting standards. The DP refers to the project on revising the hyperinflation standard on the basis that looking at a particular issue might help the IASB to learn about the issues. It isn't because IASB sees capital maintenance as a limited issue. The IASB was concerned about making the DP discussion on measurement too abstract for its audience.

One or more participants raised the following points.

* Measurement should be based on the objective of financial reporting – relevance for economic decision making.
* The DP seems to perpetuate having mixed measurement models, which will continue the trend towards more complex standards and more complex reporting. Questions arise about how the business model approach underpinning the DP would be operationalised. Some are concerned that a mixed measurement model could lead to adoption of the lowest common denominator based on the capacity of IFRS adopters.
* Measurement can only be dealt with incrementally – it's not realistic to think that it can be dealt with in a single project. However, the conceptual framework should at least identify a single most relevant default model (tied to a concept of capital/wealth) as a discipline for attaining some level of coherence. To the extent IASB addresses measurement at a standards level in a way that differs from that default, it should provide a rationale in the standard.
* If a user is looking at the value of items to the business, it would be unlikely that historical cost would (in principle) be the best basis for decision-making in most cases. Historical cost becomes meaningless over time, particularly for long-lived assets.
* In relation to historical cost, the DP inappropriately suggests that historical cost is often reliably determinable, whereas in reality, there are many ways to determine historical cost.
* There is considerable literature on capital maintenance models that the IASB could have used – it would not have to start from scratch if it were to undertake a more fundamental study of measurement.
* Identifying cash flow 'methods' as a measurement basis misses the point that cash flow methods are used to determine other measurements, such as fair values. Accordingly, they do not constitute measurement bases in their own right. It both confuses the measurement discussion and does not help rationalise the choices confronting the IASB.

* Given the DP's views on definition and recognition, it appears that it all comes down to measurement, and therefore it's important that robust concepts around measurement are developed.
* Presentation can help overcome the problems with a mixing measurement models.
* If a mixed measurement model is adopted, the focus should be on the reasons for holding assets and liabilities rather than simply being based on the type of entity.