List of Submissions to ITC 29 *Review of IASB's Conceptual Framework for Financial Reporting*

1 School of Accounting - University of Technology, Sydney
2 Australian Investment Company Services
3 UTS Business School - University of Technology, Sydney
4. Australasian Council of Auditors - General
5. Macquarie University
6. Representatives of the Australian Accounting Profession
(CPA Australia and The Institute of Chartered Accountants in Australia)

UNIVERSITY OF TECHNOLOGY SYDNEY

School of Accounting
City Campus
1-59 Quay Street
Haymarket NSW 2000
PO Box 123 Broadway
NSW 2007 Australia
T: +61 2 9514 3560
F: +61 2 9514 3669
www.uts.edu.au
UTS CRICOS PROVIDER CODE 00099F

29 October 2013

The Chairman
Australian Accounting Standards Board
P O Box 204
Collins Street West VIC 8007
Australia

The Chairman
International Accounting Standards Board
30 Canon Street
London EC4M6XH
United Kingdom

standard@aasb.gov.au

A Review of the IASB's Conceptual Framework for Financial Reporting
ITC 29
DP/2013/1

Dear Sirs

In relation to the above exposure draft I would like to comment as follows.

Question 2:

1. Changes to the definition of an asset and a liability recognizing that they present resources and obligations are considered appropriate. The reference to future economic benefits and sacrifices confuses the issue of measurement with definition.
2. The changes relating to control for assets and obligation for liabilities are more problematic. My views are shaped by the belief that accounting operates in an economic context, and that an integral part of recognizing an asset is the ability to control its use. This likely has implications for consolidation and circumstances where partial use of an asset (25% interest in a cable) is acquired. This is also inconsistent with the general understanding of assets by users. In relation to liabilities I support the view that liabilities be practically unconditional. This again reflects the belief that accounting operates in an economic context, and can be considered the parallel requirement to above for assets. It also recognizes that if a strictly unconditional view were prescribed this would likely lead to transactions being structured to avoid legal obligation and avoid recognition.

Question 3:

3. I do not support the omission of uncertainty from the definition's of assets and liabilities if this leads inexorably to a probabilistic / expected value measurement system for all assets and liabilities. This would elevate complexity in financial reports and increase significantly subjectivity in the preparation of financial reports. I interpret 'expected' as sufficiently likely, and indicating a dichotomous approach to recognition (0/1), and as such it is not a statement

about measurement. Clarification on the interpretation of 'expected' and its implications for regulations could be provided.

Question 10:

4. The framework should retain equity as a residual amount, but the proposals to measure equity are inconsistent with this. Measuring equity as a residual avoids the possibility that an item either meets the definition of both and liability and equity, or neither. Additionally, you can't measure a residual, and any attempts to do so will require the inclusion of a balancing item which can't be independently determined.

Question 16:

5. In the framework there is no 'strategy' or basis for considering presentation and disclosure issues should be addressed. Presently the format of financial reports is simply to use the financial reports as a 'coat hanger' from which notes are referenced, and there is no consideration of the disparate capabilities of financial statement readers. It seems they are all presumed to be experts. Adopting a presentation strategy whereby more novice readers could simply read and appreciate the major statements (presentation) is one possibility. Such a strategy might also address the increasing incidence of non IFRS / proforma income numbers being promoted by companies. This suggests that note disclosure adds detail for more expert users of financial reports.

Questions 19-21

6. Again it seems as there is no strategy or framework for distinguishing components of income and OCI and this suggests a continuation of the current situation where companies have been able to completely lose expenses in OCI (e.g., defined benefit plan accounting). This seems to identify some income (gains) and expense (losses) items as more / less relevant by nature when there may be no evidence of this, and it further justifies the disclosure of non IFRS / proforma income disclosures (evidenced by these adjustments occur in the income statement as well). This also ignores two fundamental relations that should exist in sets of financial reports, and this would make the use of such statements more complex and difficult (e.g., valuation models using comprehensive income).
    a. Balance sheets (opening and closing) and income statements should articulate.
    b. All income (gains) and expense (losses) items should be included in the income statement, at some time. There may be issues with timing, in which case use OCI for deferral. However, all items should be recycled into income and OCI should sum to zero over time.

I would like to thank you for this opportunity to comment on this Discussion Paper .

Yours faithfully

Peter Wells

AICS
Australian Investment
Company Services

Australian Investment
Company Services Limited
ABN 40 117 732 635
AFSL 303209
Level 21, 101 Collins Street
Melbourne Victoria 3000
Mail Box 146, 101 Collins Street
Melbourne Victoria 3000
Telephone 03 9650 9911
Facsimile 03 9650 9100

7th November 2013

Mr Kevin Stevenson,
Chairman & CEO,
Australian Accounting Standards Board,
PO Box 204,
Collins Street West,
Victoria 8007

via e:mail to standard@aasb.gov.au

Dear Kevin,

ITC 29 A Review of the IASB's Conceptual Framework for Financial Reporting - July 2013

Thank you for the invitation to participate in the Conceptual Framework Forum held this week which I found very useful.

Rather than answer the specific questions posed by the IASB I have given below in writing some of the comments that I made verbally during the meeting for your consideration in framing the response of the AASB and the Asia-Pacific standard setters to the Discussion Paper.

1. Definition of liability

An entity needs to be able to create a liability for an event that is probable, even if the actual final value of that liability has yet to be known. The example given was where an entity expenses over 4 years an incentive payment to employees that is dependent on performance hurdles over those 4 years. There is a question as to whether this is a 'View 2' or a 'View 3' as the liability can be said to be practically unconditional from the entity's point-of-view (if the employee is still employed at the balance date) although the actual amount will be conditional on the entity's future actions.

2. Obligation to issue shares

Consideration needs to be given to the detail with regards the Statement of Changes in Equity and some likely instruments that would give rise to an obligation to issue shares before guidance is finalised.

The example given was with regards to convertible notes – these are debt instruments that will simply be converted to equity on conversion, often at a pre-determined price. There is already some recognition of their effect on future cash flows by virtue of the requirements for diluted EPS figures.

To separately record changes in the fair value of the optionality of the convertible note in the Statement of Changes in Equity would not add anything of value to a user of the accounts –particularly where the fair value of the convertible notes themselves is easily obtainable (e.g. quoted) – as the simple debt for equity swap has no effect on the total equity of the entity.

3. Puttable Instruments

There should be recognition in a conceptual framework that the accounting for an instrument in one entity (e.g. the issuer) should not necessarily constrain the accounting for that instrument in another entity (e.g. the holder). For instance, the question of whether or not to bifurcate a puttable instrument might only be relevant to an issuer – an entity holding such an instrument that is quoted on a recognised securities exchange as an investment should be able to treat it as a single instrument at fair value.

Similarly, if such an investment is treated by the entity holding it the same way as other equity investments and it is held for the same reasons, that entity should be able to treat it using the equity exemptions under AASB 9. For example, the Hastings Diversified Utility Fund (HDF) instruments which gave the holder ownership interests in the assets of the stapled securities and which were quoted on the ASX should have been eligible for treatment under the equity exemption.

This enables accounting treatment to be determined to a certain extent by the intention and business model of the entity (but not, I would suggest, merely by the type of entity, as different investment entities have different business models). As the IASB has already noted, such accounting determinations once made should in most case be irrevocable.

4. Statement of Comprehensive Income

The current differentiation between the P&L/Income Statement and Other Comprehensive Income is useful. The P&L shows income (i.e. revenue) derived from assets and expenses incurred in deriving that income. It should, as far as possible, reflect the ‘underlying profits’ of the entity (a term that is used by most listed companies, and was the subject of a paper by the AICD and Finsia in 2008).

To combine the two statements would be misleading to most retail shareholders, as they would confuse the ‘total comprehensive income’ figure for the underlying profit figure.

Whilst Approach 1 which suggests no recycling between the two statements has attraction, there may well be some few items such as cash-flow hedges on future transactions which are better recycled if they relate directly to revenue being derived from the assets of the entity, as otherwise the revenue shown on the P&L would not reflect all of the costs incurred in deriving that revenue.

Fair value movements on assets that are subsequently realised should not be recycled through P&L – this is perhaps reflective of an approach to 'capital maintenance' that was briefly discussed.

5. Subsequent Measurement Basis

Fair Value should be the default method of measurement for all assets and liabilities and even where considered not appropriate, disclosure of fair value where possible should be made.

The discussion indicated that 'current exit price' be the most relevant measurement basis for assets that are to be sold. Care should be taken with regards to assets that have a quoted price that there is not a return to 'last bid price' as a specified measure. Markets generally use last sale price, which is often a mid-point between last bid and last offer, and therefore an acceptable indicator of current exit price.

Assets that are held for investment purposes (i.e. to derive an income or in expectation of future income) should as a default option be valued at fair-value, particularly where an active market exists for the assets.

The above points are designed to reflect the point as that I made during the day, and I am happy to expound on them as necessary at your convenience.

Thank you for the opportunity to contribute.

Yours sincerely,

Andrew Porter
Chief Financial Officer

UNIVERSITY OF TECHNOLOGY SYDNEY

Dr Robert Czernkowski PhD BCom CPA
Senior Lecturer,
Accounting,
UTS Business School
Building 5, Room C.325
City Campus
1-59 Quay Street
Haymarket NSW 2000
PO Box 123 Broadway
NSW 2007 Australia
T: +61 2 9514 3736
F: + 61 2 9514 3669
www.uts.edu.au
UTS CRICOS PROVIDER CODE 00099F

8th November, 2013

Chairman,
Australian Accounting Standards Board,
P.O. Box 204,
Collins St. West, Vic., 8007
Australia

Chairman,
International Accounting Standards Board,
30 Canon Street,
London, EC4M6XH,
United Kingdom

standard@aasb.gov.au

A review of the IASB's Conceptual Framework for Financial Reporting,
ITC 29
DP/2013/1

Dear Sirs:

Many thanks for the opportunity to participate in the AASB Forum on the Conceptual Framework, discussing the IASB's Discussion Paper (DP) relating thereto.

Our concerns at a broad level reflect the general lack of both clarity and rationale for changes proposed by the IASB to the Conceptual Framework. At a more substantial level, we are concerned that the logical coherence of the existing Conceptual Framework (being an aspirational document) is being sacrificed as the DP moves the Framework toward being an imperfect toolbox. The DP would have a Conceptual Framework that retrofits existing practice, rather than leading standard setting.

We do not intend to provide detailed analysis of issues which the Boards (AASB and IASB) have thoroughly researched. Instead, we wish to focus on the salient points. We refer to the IASB proposed framework as the Conceptual Framework (CF) throughout.

1. **Motivation.** It has been asserted that the CF project is intended to address deficiencies in the existing CF. Unless it is made clear what these deficiencies are, it is not possible to evaluate whether the proposals in the Discussion Paper take a step forward over the current CF.

2. **Conceptual integrity.** A second general point: the DP seems to have abstracted away from concepts towards retrofitting current practice. This is a concern. A coherent CF that acts as an ideal for practice is optimal, as it articulates consistent principles. Departures from these principles would then be clearly flagged as exceptions, possibly politically motivated, or prompted by non-recurrent events of financial and economic significance, which amplify the problems in standard setting and implementation. The CF would nonetheless stand inviolate as a statement of the optimum. The proposed changes to the CF render it a political grab-bag of concepts.

This is especially the case in the proposed measurement "principles". Indeed, we see no principles. The theoretic link between a financial statement **element**, through the **attribute** being measured, to the **measurement basis** has been vitiated through a total omission of attribute discussion.

In our view, many questions need to be considered before measurement can be addressed sensibly. Even if an attribute or set of measured attributes can be decided upon, what approach should be taken? Should the measurement proceed from a stewardship perspective or user's perspective? Different perspectives will determine the way items are measured. Should the proposed CF be so specific about the measurement rules or should it be taking the stand of providing guidance at a broader level? In our opinion, the measurement part stands out as overtly inconsistent with the general principles that the rest of the CF is trying to provide.

A much more honest approach would be to admit that agreement cannot be achieved, and simply leave the measurement section of the CF incomplete. It could be addressed at a later date after further deliberation. That would be much more straightforward and intellectually honest than the incoherent grab-bag of measurement that the DP proposes.

The real reason we have lack of agreement on a measurement basis is that not all preparers can agree on what should be measured. The IASB would be better focussed on undertaking a financial attributes project. Once people have been exposed, over a period of years, to the idea that we need to select (an) attribute(s), perhaps choosing a measurement strategy will be a much more defensible step. But the preparatory work needs to be done on attributes first. Selecting a single measurement basis may be an uncomfortable choice – historical cost or fair value – but definitely requires more deliberation and discussion than the current DP provides.

3. **Asymmetry.** The proposed CF has asymmetric measurement rules. There is a tendency to recognise liabilities by removing the probability test, but the recognition of assets is much more conservative. For example, Views 2 and 3 on Liabilities require some assumption that the entity will be around to discharge these liabilities, hence they should be recognised.

   We recall the example mentioned in the Sydney Forum on 15th October. It related to recognising – as a liability – a levy from operating a train (where obligating events for the levy are all kilometres travelled beyond the 900 000th in the calendar year), even when only 600 000 km have been achieved by the end of the financial year. If there is an assumption that an entity will be around to pay the levy (hence the liability), why not also assume that we will be around to earn the income (hence record an asset)? Conservatism is not a reasonable argument for this. An accounting policy that has conservative effects on equity (reducing it) may not have conservative effects on ratios that use that number (e.g. ROE). The conservatism caused by asymmetry may in many cases yield over-optimistic performance measures.

4. **Inconsistent terminology.** "Income" is now used in the sense of revenue (i.e. "income" is *revenue* and *gains*). But it is also used in the traditional sense of "earnings" as in "Other Comprehensive Income". This results in terminological confusion which needs to be addressed.

5. The **new definitions** of assets and liabilities ostensibly remove the future and refer now only to the past and the present. This is great. Accounting should not reflect what preparers think might happen in the future.. The future is up to investors to consider for themselves, and – insofar as assets are concerned – this seems to be the view taken in the DP. In contrast, however, the guidance for liabilities **<u>does</u>** choose to look into the future, if either of Views 2 or 3 are to be considered seriously. This underscores the points made about asymmetry before. If we introduce a conservative bias into liabilities, then we also introduce an anti-conservative bias into derived measures, such as ROE. Because we cannot anticipate how our information is used, and/or whether conservatism will induce an optimistic bias, we should aim for neutrality rather than conservatism.

   We are aware that prudence is no longer a guiding issue. However, it still implicitly underlies much practice.

6. **Control.** In a preliminary comment, the AASB seems to be of the view that control may be more appropriate as merely a recognition criterion. We do not agree with this. Either control or ownership must be present in the definition. The key elements of an asset are not merely that the resource exists, but that it is somehow related to the entity.

7. **Recognition criteria.** There should be no reference to recognising "*unless information is not relevant or insufficiently relevant to justify cost"*. This is – in a sense – reflecting materiality and/or the cost-benefit trade-off. For immaterial information, standard application is irrelevant – do we really need to say this? If so, does it belong in recognition criteria, or in the discussion of the qualitative characteristics of accounting information?

   Removing probability from the recognition criteria is consistent with 5 above. This leaves only reliability (in its form as the current jargon-de-jour, *faithful representation*) as a recognition criterion. However, unless we clarify what the attributes of assets and liabilities being measured are, how can we decide whether a particular measurement or recognition decision results in them being faithfully represented?

8. **What recognition criteria?** Having made the comments above in support of removing probability (from the <u>definitions</u>), we wish to underline that we are not in support of removing it from the <u>recognition criteria</u>. If reliability and probability go, then the remaining recognition rule seems to be: record everything unless there are measurement problems. We are not sure what this means.

9. **Statement of Changes in Equity**. The idea that we should be measuring changes in the value of equity is misguided. It is tantamount to suggesting that preparers are better at understanding how information about equity is used than the information intermediaries who use it themselves. For example, one variable for determining the potential presence of growth options is the *market to book* ratio. By attempting to reflect market, we are contaminating the ratio and eliminating this analysis route. Moreover, the idea – that preparers know best about what users of this information want – risks taking us down the same route as the IAS33/AASB133 fiasco.

10. **Secondary equity claims.** We have a fundamental problem with the idea that secondary equity claims are always equity even if they are really liabilities. For example, the proposed CF would classify as equity a liability (say a share-based payment) where settlement is for a variable number of equity instruments to meet a fixed quantum of currency units. Now, whether something is an asset does not depend on whether the benefits inherent in that item are realised in cash, services or chickens. Why then should an obligation be classified variously as debt or equity depending on the mechanism of settlement? This is a conceptually flawed suggestion.

The chief difference between equity and debt superficially has two aspects. They lie in different parts of the risk spectrum; and, more importantly, a liability is a fixed claim whereas equity is a residual. Of course, something may be partly residual (e.g. certain liabilities with variable payouts, such as a variable rate loan). So ultimately, the only thing that matters is the risk spectrum. Nonetheless, the example cited (a Share Based Payment payable in shares but at a rate specifying a fixed and determinable cash equivalent) is clearly at the low-risk/liability end of the spectrum. We must first strengthen the definition of liabilities; then the definition of the residual (equity) follows implicitly.

11. **Seeing equity where there is none.** A more significant concern stems from the existence of entities where there is no equity: i.e., certain types of trust structures, and Defined Contribution Pension schemes. The DP would have the "most subordinated" liability recorded as equity. We are not convinced that this makes sense. Although trusts and DCP entities are not (yet) within the remit of existing IASB standards, they (a) are within the remit of "AusIASB", i.e. AASB standards, and (b) may be addressed by the IASB in future. Changing this definition of equity will have unforeseen flow-on effects when and if these issues are addressed.

12. **Other Comprehensive Income (OCI).** There is no clear conceptual basis for, or definition of, OCI. Therefore, we cannot determine what should be in or out of OCI without knowing OCI's presumed information role. As in days of yore, it seems to be trying to achieve a parking place for things that various people from time to time will argue as "inconvenient" for performance. Any such dividing line is arbitrary at best.

Let's be honest. OCI is just the latest reincarnation of the *abnormal items/extraordinary items* issue. However, even with the existence of OCI, we still see companies making up their own non-GAAP numbers and using them to communicate performance to shareholders/investors. We have seen a proliferation of concepts such as "cash earnings", "pro forma earnings", "underlying earnings", etc. No matter what we do with OCI, and however we redefine the concept, we will leave some people unhappy.

There is a fundamental tension between reporting total wealth change of shareholders, and allowing managers to point at a number which reflects what they control versus what they don't. Underlying all these arguments about *extraordinaries/abnormals* or OCI, and about the way OCI is interpreted in particular standards, is this same latent issue. This issue can only be addressed at the standard level, not the CF level; set a standard for reporting an adjusted profit that allows managers to point to a number and say "this is what you should hold us accountable for, because it reflects things that we control". By keeping managers and boards happy with one of these numbers, you will find that they care little about which parts of total wealth change are called Profit, and which are called OCI.

Even if the above is unpalatable, something must be done about OCI. There is no one characteristic that is constant across all OCI numbers. Realisation? What if we have market-to-market financial instruments that are so liquid that they may as well be cash-like?

In general, there seems to be no coherent concept of what OCI should be. It is argued by one of our colleagues in a separate submission that OCI should catch items from "mismatches". However, the idea of "matching" (and consequently of "mismatches") has died long ago. There is no coherent argument for separating Profit from OCI. If the argument is a quality-of-recognition argument, then it is not an argument about OCI, but an argument about recognition.

13. **OCI as a Rubbish Dump.** To summarise the argument from 12: Everyone we have heard speak about OCI describes it as the place to put items that do not reflect performance. The only problem is that each person wants to place different things there. OCI serves the same role as *pro-forma profit* or *underlying earnings*; it helps us define the profit we "want to report", rather than a comparable and consistent profit. It is the "extraordinary items" of our day; i.e., it is where we park inconvenient rubbish.

14. **Recycling.** OCI articulates Profit to the Balance Sheet. Although cross-statement articulation may be important, time-series articulation can be argued to be just as important (especially for analysts who attempt to construct predictive models). If neither the *sum of Profit* on the one hand, or the *sum of Profit plus OCI* on the other, yields the total profit over the life of the business, then users' ability to sensibly determine (let alone interpret) trends is vitiated. If we must have this OCI monstrosity, then at least do not undermine articulation; recycle everything or nothing. Using a consistent recycle all or nothing is a more comparable alternative to piecemeal treatment.

15. **An alternative to OCI.** Keith Reilly made a proposal at the Sydney Forum on 15th October, which is consistent with 12 above. The proposal has merit: report a Comprehensive Income measure that does not differentiate between normal profit and OCI; then let companies report a second number/statement where they can say "Hey! This is the number you should be looking at." These second numbers can be argued against on the basis that they would just be "profit without the bad bits". However, such numbers are already out there: *pro-forma profit, underlying earnings* and *cash earnings* are rubbish. All that OCI does is take the right to generate rubbish away from individual firms, and give it to the standard setters (in effect: stakeholders who can be bothered lobbying strongly enough, inconsistently from issue to issue).

16. **OCI and volatility/accountable performance.** Excluding items such as gains/losses of pension funds, even though they have a real economic effect on companies (e.g. General Motors) may be convenient, but it hides performance. You can say that the volatility of pension funds is not something that should be reflected in performance. Managers can tell these stories. But I am not sure that users (shareholders or taxpayers) of financial information buy these stories. Just because users are too

disparate to participate in standard setting does not mean that we should show them such callous disregard. "*Promote disclosure of useful entity-specific information*" seems to justify information overload without considering how users use reports.

17. **Presentation.** Under presentation, references to nature/function and so forth in the objective of financial statements seem to exemplify unnecessary micromanagement in the CF of issues which should properly be dealt with in substantive standards.

18. **Existing primary statements.** We are generally happy but, if the IASB is to insist on the existence of OCI, then we strongly object to the ability to report OCI in a separate statement from Income. Total changes in the wealth of shareholders due to the operations of the business should be reported on a single statement, preferably on one page. The best performance statement ever, in our opinion, was the last Australian pre-IFRS Income statement. Everything was profit, except for three exceptional categories: revaluation, foreign currency translation changes and fair value hedges. Even so, they were reported on same page as the Income Statement.

19. **Uncertainty.** One argument for OCI is the idea that some information is of lesser quality, because of problems with realisation or (in the case of hedges) accounting not reflecting economic reality. If these are the problems, then address them directly not indirectly. If a hedge of a forecast transaction is a real economic hedge, then find a way of recording the notional gain/loss from which the hedge insulates the entity. If information quality is an issue, then how about thinking outside the box?

    An alternative profit measure as already discussed can easily be generated from well-designed accounting systems.

In summary, the DP would move the CF backwards. The IASB has identified something that is broken – without specifying exactly how – and has moved to address these unspecified deficiencies by hitting the CF with a sledge hammer (breaking it some more) rather than seeking to improve it. These are changes for changes' sake.

We have already squandered coherence by adopting the artificial American bifurcations firstly between revenue and gains, and secondly between losses and other expenses. Although this has moved us closer to the FASB, the usefulness of the bifurcations is doubtful. As long as OCI exists, it allows people to dump items they don't like into OCI on an inconsistent standard-by-standard basis.

We are not ideological puritans. The fundamental problem with the DP is that it proposes a set of changes without a coherent explication of what is wrong with the current CF. As such, it is difficult to measure whether the DP looks like succeeding. .

Up until now, there has been a semblance of principle and conceptual integrity in the CF. These proposed revisions to the Conceptual Framework vitiate this.

Sincerely,

Dr. Demi Chung	Dr. Victoria Clout	Dr. Robert Czernkowski
University of New South Wales	University of New South Wales	University of Technology, Sydney

AUSTRALASIAN
COUNCIL OF
AUDITORS-GENERAL

8 November 2013

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Dear Mr Stevenson

AASB Invitation to Comment ITC 29 - *A Review of the Conceptual Framework for Financial Reporting*

Please find attached the Australasian Council of Auditors-General (ACAG) response to the questions in ITC 29.

The views expressed in this submission represent those of all Australian members of ACAG.

The attachment to this letter addresses the specific questions asked by the Board and articulates our views in more detail. Attached also for your information is a copy of the ACAG response to the International Accounting Standards Board's Discussion Paper DP/2013/1 - *A Review of the Conceptual Framework for Financial Reporting*.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

PO Box 275, Civic Square ACT 2608, Australia
Phone/Fax: 1800 644 102 Overseas phone/fax: +61 2 9262 5876
Email: soneill@audit.sa.gov.au
Website: www.acag.org.au
ABN 13 922 704 402

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. **Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views, particularly any issues relating to:**
   (a) not-for-profit entities; and
   (b) public sector entities, including the implications of the preliminary views for GAAP/GFS harmonisation;

   ACAG is not aware of any issues in the Australian environment that may affect the implementation of the preliminary views in relation to not-for-profit entities or public sector entities. However, ACAG notes there may continue to be a need for Aus paragraphs in the AASB Conceptual Framework. This would be assessed when the IASB issues an ED of its revised Conceptual Framework.

2. **Whether, overall, the preliminary views would result in financial statements that would be useful to users;**

   ACAG believes that, overall, the preliminary views would result in financial statements that would be useful to users.

3. **Whether the preliminary views are in the best interests of the Australian economy; and**

   ACAG has no comment to make on this issue.

4. **Unless already provided in response to specific matters for comment 1 -3 above, the costs and benefits of the preliminary views relative to the current treatments, whether quantitative (financial or non-financial) or qualitative.**

   ACAG believes that the preliminary views would provide benefits by clarifying the matters raised in DP/2013/1. ACAG does not believe that implementation of the preliminary views would involve significant costs.

   ACAG believes that the comparability of financial statements would be greatly enhanced if the IASB were to develop a single measurement basis for financial statements.

ACAG AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

8 November 2013

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr Hoogervorst

IASB Discussion Paper DP/2013/1 - *A Review of the Conceptual Framework for Financial Reporting*

Please find attached the Australasian Council of Auditors-General (ACAG) response to the questions in IASB Discussion Paper DP/2013/1.

The views expressed in this submission represent those of all Australian members of ACAG.

The attachment to this letter addresses the specific questions asked by the Board and articulates our views in more detail.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

PO Box 275, Civic Square ACT 2608, Australia
Phone/Fax: 1800 644 102 Overseas phone/fax: +61 2 9262 5876
Email: soneill@audit.sa.gov.au
Website: www.acag.org.au
ABN 13 922 704 402

ACAG RESPONSE TO QUESTIONS PUT IN DISCUSSION PAPER DP/2013/1

Question 1

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; and

(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 that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

ACAG agrees with these preliminary views. A clear primary focus is important in drafting the conceptual framework. Having said that, a clear and comprehensive conceptual framework also provides important guidance for preparers and auditors and assists in the development of IFRSs.

ACAG believes departures from the conceptual framework should be kept to a minimum, because every departure reduces, to some extent, the consistency of financial reporting. AGAG agrees that it is important to describe the departure, and the reasons for the departure in the Basis for Conclusions; preparers and auditors should never be left guessing whether a departure was intended.

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?

ACAG agrees with the proposed definitions.

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 paragraphs 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?

ACAG agrees with the IASB's preliminary views. ACAG notes that some unusual assets/liabilities with a low probability of inflow/outflow of economic benefits can create seemingly odd results. ACAG believes this could normally be addressed at the Standards level, although some guidance in the Conceptual Framework as to when recognition is unlikely to be appropriate would be useful (e.g. Paragraph 4.25-4.26).

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?

ACAG believes it would be helpful to identify these items as elements of the financial statements. As noted in our response to Question 1, the more comprehensive the framework, the more useful it would be to preparers and auditors.

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?

ACAG has considerable experience with constructive obligations, operating as it does in the Australian public sector. Governments frequently make promises, of varying specificity, and preparers and auditors need to decide in each case whether a liability results. Our experience with the current definition is that it leaves too much room for differences of opinion on when an entity has a liability.

On the other hand, limiting recognised liabilities to those that are legally binding risks excluding many obligations that, in economic substance, will be binding on the entity.

ACAG agrees that liabilities should not be recognised merely because an entity is economically compelled to act in a certain way. An entity should not recognise a liability unless it has made a promise to another party, or is subject to a legal requirement.

ACAG agrees that additional guidance to distinguish constructive obligations from economic compulsion should be provided at the Conceptual Framework level (as per Paragraphs 3.50-3.54).

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.

ACAG supports View 2. If the entity does not have the practical ability to avoid the transfer of economic benefits through its future actions, it has a present obligation. In ACAG's view, recognition of liabilities where there is no practical ability to avoid the obligation provides the most faithful representation of an entity's financial position. View 1 is not supported because an obligation should not be omitted from financial statements merely because there is a theoretical possibility of avoiding the liability; financial statements should reflect the reality of the business, not theoretical possibilities. View 3 is not supported because an obligation that is conditional on future actions that the entity realistically could avoid should not be recognised as a liability.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

In paragraph 3.110(a), the IASB states that enforceable executory contracts give rise to a net asset or a net liability. It is not clear to ACAG why this should be so. Executory contracts will typically give rise to a liability and an asset, but is not clear, conceptually, why they should be netted. ACAG believes that the conceptual framework should address why assets and liabilities arising from executory contracts should be treated any differently from other assets and liabilities. The discussion in paragraph 3.109 to 3.112 focuses on existing practices, rather than proposing a conceptually sound solution.

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?

ACAG agrees with the IASB's preliminary view. Recognition of all assets and liabilities, except where an IFRS provides otherwise, promotes consistency and conceptual integrity in financial reporting. We agree, as stated in Paragraph 4.26, that the Conceptual Framework should provide further guidance (indicators) to assist the IASB to assess when recognising an asset or a liability might not provide relevant information. It may also be beneficial if unrecognised assets and liabilities were disclosed in the notes and the IASB explains why it has determined recognition of such assets/liabilities is inappropriate.

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?

ACAG agrees with the IASB's preliminary view. Derecognition of an asset or liability when it no longer meets the recognition criteria is logical. The requirements if the entity retains a component of an asset or a liability are best dealt with at the Standards level.

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

(b) the *Conceptual Framework* 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 paragraph 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?

ACAG agrees with the IASB's preliminary view. Treating equity as a residual interest is a more robust solution than attempting to define equity.

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.**

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

(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;**

(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.**

(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**

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

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?

ACAG agrees with the propositions at (a), (e) and (f) above, but disagrees with the other propositions.

ACAG sees a single measurement basis as an important part of any conceptual framework.

Since accounting is essentially a measurement exercise, it is vital to be clear as to what the financial statements are attempting to measure. Therefore, each of the primary financial statements should have a consistent measurement basis, which would give meaning to the totals in each case. It is illogical to add the cost of some assets to the fair value of others and then claim that the total assets figure is a meaningful number, without further explanation.

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.

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

(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.

(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.

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.

ACAG disagrees with the IASB's preliminary views. See our response to Question 11.

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.

(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).

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

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.

ACAG disagrees with the IASB's preliminary views for the reasons set out in our response to Question 11.

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?

ACAG disagrees with the IASB's preliminary view, for the reasons set out in our response to Question 11.

Question 15

Do you have any further comments on the discussion of measurement in this section?

ACAG has no further comments on measurement.

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 *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and

(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 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 the Financial Statement Presentation project;
(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*.

ACAG agrees with the IASB's preliminary views.

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?

ACAG agrees with this approach. In particular, while materiality is already appropriately defined in IFRSs, we think guidance on how to apply the concept of materiality in the context of IFRSs would be useful.

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?

ACAG agrees that the communication principles in paragraphs 7.48 to 7.52 should be part of the Conceptual Framework. ACAG believes these principles will go some way towards counteracting a tendency for disclosures to be interpreted in a rules-based manner.

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?

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?

ACAG agrees that the Conceptual Framework should require a total or sub-total for profit or loss, provided that that term is defined or, at least, distinguished from OCI (see paragraph 8.35) in the Conceptual Framework in a meaningful and conceptually rigorous way.

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 recognised 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?

If you do not agree, how would you address cash flow hedge accounting?

ACAG's view on this matter would depend on how the concepts of profit or loss and OCI are distinguished, and on how these are presented in the financial statements. However, we believe that the relegation of items of income and expense to OCI should be minimised.

Question 21

In this Discussion Paper, 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 Discussion Paper.

ACAG would prefer a different approach. ACAG believes that neither Approach 2A nor 2B have conceptual rigour. For example, the following statement at paragraph 8.40(a):

> "Principle 1: items of revenue and expense presented in profit or loss provide the primary source of information about the return an entity has made on its economic resources in a period."

is not very useful, because it immediately begs two questions: what is (or should be) the 'primary' source and what is a "return"? To be useful, these concepts would need to be more fully developed than they are in the Discussion Paper.

If the IASB does not wish to develop a conceptually rigorous distinction between profit or loss and OCI, ACAG suggests the presentation of the income statement be addressed at the IFRS level.

If the IASB does wish to investigate a conceptually rigorous distinction, ACAG suggests separating realised from unrealised income/expense. This would at least provide a logical basis for recycling ie when previously unrealised gains are realised.

Question 22

Chapters 1 and 3 of the existing **Conceptual Framework**

Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* 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 *Conceptual Framework* 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*.

ACAG agrees that the IASB should not fundamentally reconsider Chapters 1 and 3 of the Conceptual Framework.

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper 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?

ACAG thinks it would be appropriate to use the business model concept when developing or revising standards. ACAG has no definite view on when this would be the case.

ACAG does not believe that the IASB should define 'business model'. This term is already well understood.

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?

ACAG agrees that the unit of account should normally be decided when the IASB develops or revises particular Standards. ACAG believes the issue is too specific to be decided at the Conceptual Framework level.

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?

ACAG is not aware of 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.

ACAG has no view on this issue. The Australian public sector has not been in a high inflation environment for many years and the capital maintenance paragraphs in the existing Conceptual Framework are rarely used.

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

Mr Kevin Stevenson

Chairman

Australian Accounting Standards Board

By Email: standard@aasb.gov.au

20 November 2013

AASB ITC 29/IASB Discussion Paper DP/2013/1 A Review of the Conceptual Framework for Financial Reporting

Dear Kevin,

Macquarie University's Department of Accounting and Corporate Governance is pleased to provide the Australian Accounting Standards Board (AASB) with its comments on AASB ITC 29 which is a re-badged copy of the International Accounting Standards Board's (IASB - the Board) Discussion Paper DP/2013/1 A Review of the Conceptual Framework for Financial Reporting (the DP). We have considered the DP, as well as the accompanying draft Basis for Conclusions.

Macquarie University's response reflects our position as a leading educator to the Australian and global community. This submission has benefited with input from discussions with key constituents, and in particular we appreciate the opportunity to be a participant at the Australian Accounting Standards Board's (AASB) Sydney Roundtable on 15 October 2013 where the DP was extensively discussed and was attended by key constituents and representatives of the AASB and staff.

We broadly support the proposal to revise the Conceptual Framework, and appreciate the effort that the IASB has put into this project. However we do have concerns as to whether the DP is set at the conceptual level which we believe should be 'aspirational', as there are a number of proposals that seem to us to be at the more detailed standards level. After all, the intent of the Conceptual Framework as set out on page 5 of the Summary is to assist the IASB by identifying concepts that can be consistently applied when developing and revising international financial reporting standards (IFRS).

We note that the International Public Sector Accounting Standards Board (IPSASB) is also working on its Conceptual Framework, and we suggest that the IASB should work with the IPSASB rather than just consider (1.15) as most of the aspirational concepts should be similar if not identical.

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

Whilst we are disappointed that this Conceptual Framework is no longer a joint project with the US Financial Accounting Standards Board (FASB), we support the IASB proceeding without US support.

At this time we do not believe that the next step is an Exposure Draft, unless there are significant amendments made to this DP, to make it more 'aspirational'.

Our specific comments on the DP are as follows:

SECTION 1 INTRODUCTION

Question 1

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; and

(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 that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

We broadly agree, except as detailed below:

However we would expect that any departure from the Conceptual Framework would be identified and explained at the Discussion Paper or Exposure Draft stage. We also suggest that the IFRS for SMEs implications of any changes in the Conceptual Framework should be considered as part of this review, given that IFRS for SMEs is based on IFRS but simplified. We note that the IFRS for SMEs accounting standard sets out the Objectives, Concepts and basic Principles in Section 2 of that standard.

We see some challenges throughout the Discussion Paper on the level of detail that should be contained in a Conceptual Framework compared to specific accounting standards, and a good example is equity versus debt.

Some further consideration is needed on the purpose of financial statements that then drives the accounting rules that follow. Whilst there is no objection to the meeting the needs of users, surely a 200 page or more set of financial statements that IFRS apparently dictates, cannot in

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

any way be seen to helping users make rational economic decisions. Perhaps it is time to recognise more modern communication methods apart from printed financial statements. The absence of any alternative to the needs of capital markets is also questionable, given that stewardship remains an important issue for those entities that are not listed on a capital market and yet wish to remain in a IFRS rather than an IFRS for SMEs framework. This has particular implications for the measurement framework, as indeed for capital maintenance that dictates when a transaction results in capital as against income.

Given the purpose of a Conceptual Framework and its length of time it is expected to be used before any major amendments, the absence of any 'future developments' section is surprising, particularly having regard to how users access information about commercial and indeed non-commercial entities. Again this is also relevant to society needs generally as without the support of society, no business has a mandate for its own existence. A particular example is the often made statement that many companies' balance sheets exclude 70-80% of the real assets, due to the ban on including intangible assets that have been internally generated or significantly increased in value post a market based transaction.

We suggest that the IASB should not be overly dictated to its existing timetable, as it is important that the IASB spends time considering the various submissions and meeting with those that have made submissions as well as key constitutes such a Governments.

In some of the suggested changes, we would expect that more specific evidence would be provided as to both why a change is needed and why the particular solution is being recommended.

We also suggest that more practical examples be provided so that the basis behind the particular issue can be better understood. This would be particularly helpful in the Equity and Liabilities sections. For example what is the practical implementation issues if a pure equity model is selected having regard to prudential regulators who are insisting on greater capital requirements and which lead to quasi equity/debt instruments that can be considered as Tier 1 capital. Other issues such as the relevance or fair valuing assets that are most unlikely to ever be able to be realised at such values (valuing trees in botanical gardens or fair valuing debtors), would also assist in evaluating the concepts.

SECTION 2 ELEMENTS OF FINANCIAL STATEMENTS

Question 2

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

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 broadly agree, however we suggest that some further discussion is needed on why the 'result of past events' is needed as the more important criteria is the 'present obligation'.

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 paragraphs 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?

We do not agree as probability is relevant to whether an asset or liability exists. If the likelihood (probability) is 1% does that differentiate an asset or liability where the probability is 51% or 99%? We suggest that probability needs to be considered, but leave it to the standards to measure, so on that basis we do not agree with specific probability thresholds as that is a standards issue.

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

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

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?

We support a single Results (Profit & Loss) Statement as there is just too much confusion with the concept of Other Comprehensive Income (OCI) and the challenges with recycling. A single statement of financial performance does make sense and then it is up to the specific standards and indeed users to determine what particular measure or measures are important.

We find the discussion around discretionary reserve allocation and whether it should be part of OCI or left as an equity classification challenging. By way of example a prudential regulatory requirement to maintain an increased buffer of capital is an example of equity rather than a liability.

SECTION 3 ADDITIONAL GUIDANCE TO SUPPORT THE ASSET AND LIABILITY DEFINITIONS

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?

We do not believe additional guidance at the conceptual framework stage is needed as this is a standards issue.

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.

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

(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 support View 2 without conditions.

Question 7

Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

No.

SECTION 4 RECOGNITION AND DERECOGNITION

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?

We agree.

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

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

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?

We agree.

SECTION 5 DEFINITION OF EQUITY AND DISTINCTION BETWEEN LIABILITIES AND EQUITY INSTRUMENTS

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 *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.
(b) the *Conceptual Framework* 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 paragraph 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?

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

We support a pure equity residual type model which is the residual interest in the net balance of the entity's assets after deducing liabilities for a number of reasons, but generally because it is simple to interpret and explain.

Much of the complexity in the financial instruments debate (IAS 38 and IFRS 9 plus various EDs) is about determining what is equity and as a result, what is debt. The market will always provide financial products that take advantage of whether equity or debt is more favourable.

From a practical user perspective, any analysis of financial performance and financial position is to our mind based on what are the results of transactions that add to or decrease the net equity position of the entity. So perhaps this can be best explained by requiring all transactions going through the Profit & Loss Statement including capital raisings. Initial subscribed capital received in the initial formation of a company does result in a Profit and Assets that become part of Equity. Novel, even radical, but it would solve many of the debt/equity arguments and allow businesses to proceed without masking the financial result.

SECTION 6 MEASUREMENT

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.

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

(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;

(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

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

ii. for a particular liability should depend on how the entity will settle or fulfil that liability.

(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

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

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?

We agree that there may be different measurement bases depending on the particular characteristics of the asset or liability being measured, and having regard to the practicality of obtaining a measurement base. Then it is a matter for individual accounting standards to determine specify measurement rules.

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.

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

(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.

(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.

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.

We agree.

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.

(b) a cost-based measurement will normally provide the most relevant information about:

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

i. liabilities that will be settled according to their terms; and
ii. contractual obligations for services (performance obligations).

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

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.

We agree.

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 (i.e. the asset or the liability is highly leveraged).

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

We agree.

Question 15

Do you have any further comments on the discussion of measurement in this section?

No.

SECTION 7 PRESENTATION AND DISCLOSURE

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:

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

(a) the primary purpose of the Conceptual Framework, which is to assist the IASB in developing and revising Standards (see Section 1); and
(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 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 the Financial Statement Presentation project;
   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*.

We believe that the IASB should rethink its approach to disclosure given the constant criticisms from preparers and users of the financial statements that IFRS based financial statements are too long and complex, and detract from the primary purpose of financial statements providing relevant and reliable information so users can make their own economic rational decisions.

We support the use of technology such as XBRL and encourage the IASB in its Disclosure Initiative, however we believe a more radical solution is needed. Given that IFRS financial statements are for publicly accountable entities that are mostly listed capital market organisations, we suggest that the approach adopted by the International Integrated Reporting Committee to provide a concise summary of financial reporting, makes real practical sense and is one of the reasons for the strong support for Integrated Reporting.

In our view, a 1 page Balance sheet, Profit & Loss Statement, Cash Flow Statement, and limited Notes to those Statements of 3 pages or less that highlight critical explanations including estimates and judgements, is all that most users want as a snapshot of the

organisation's financial performance and financial position. All other information that tit is argued is necessary for a fuller understanding of the organisation, should be available on the organisation's website and by use of hyperlinks to the concise financial statements.

Macquarie University's submission to the IASB on ED/2013/7 Insurance Contracts stated that the ED was un-necessarily complex due to the numerous disclosure provisions which it is argued a variety of users wanted. The major Australian insurance companies that currently follow the Australian accounting standards on Insurance which is the base for the ED have all stated that their own Board of Directors do not believe that the financial statements are able to be understood by mostly users including the Boards' themselves. It is time to re-think disclosures if IFRS financial statements are to be relevant.

As stated earlier, we do believe that the IASB needs to have a clear objective on Disclosure and that must be linked to the ability of users to be able to conveniently extract important information without unnecessary barriers to access. A simple 6 page or less concise financial statement would allow this to happen, and then allow hyperlinks for specify issues. At the moment the 200-300 page typical IFRS Annual Report fails this test.

By way of comparison, anecdotally it was stated that a recent conversion of a UG GAAP listed company's financial statements that was around 30 pages, resulted in an IFRS conversion of around 80 pages. Some field testing might be useful.

We believe that the 5 Large audit firms (Deloitte, Ernst & Young, Grant Thornton, KPMG and PWC should show leadership in this area by in addition to their IFRS specimen financial statements, should also produce what as a minimum an IFRS set of financial Statements should comprise, and a concise IFRS financial Statements, with hyperlinks. Anecdotally the blame for clutter is due in part to companies and regulators relying upon the Large Firms specimen financial statements as a minimum obligation! Perhaps the IASB should also produce its own specimen financial statements in the above 3 categories?

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?

We agree.

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

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?

We agree.

SECTION 8 PRESENTATION IN THE STATEMENT OF COMPREHENSIVE INCOME – PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

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? 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 amending Standards?

We agree.

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 recognised subsequently in profit or loss, i.e. 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? If you do not agree, how would you address cash flow hedge accounting?

We do not agree as in practice the concept of 'Other Comprehensive Income' (OCI) is not well understood and in practice is not used, instead a Profit & Loss Statement is produced as a single statement.

Question 21

In this Discussion Paper, 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

ABN 90 952 801 237 | CRICOS Provider No 00002J

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

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 Discussion Paper.

As detailed in our response to Question 20, we believe that the concept of OCI is artificial and instead support a single Profit & Loss Statement.

SECTION 9 OTHER ISSUES

Question 22

Chapters 1 and 3 of the existing Conceptual Framework Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* 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 *Conceptual Framework* 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*.

We support a review of the entire Conceptual Framework. In particular we note that the objective of assessing stewardship is as important as assessing the prospects of future cash flows.

Question 23

Business model
The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper 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?

We support including the business model in the Conceptual Framework as it is the business model that drives the accounting model.

Question 24

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

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?

We agree.

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?

We agree.

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 support the current concepts.

If you require any further information or comment, please contact me.

Keith Reilly

Industry Fellow (International Governance & Reporting)

MACQUARIE UNIVERSITY

Faculty of Business and Economics
Department of Accounting and Corporate Governance
MACQUARIE UNIVERSITY NSW 2109 AUSTRALIA

Department of Accounting and Corporate Governance - Macquarie University

keith.reilly@mq.edu.au

20 November 2013

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Vic 8007

Via email standards@aasb.gov.au

Dear Kevin

Invitation to Comment ITC 29 *A Review of the Conceptual Framework for Financial Reporting*

Thank you for the opportunity to comment on the above ITC. CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) have considered it and our comments are set out below.

CPA Australia and the Institute represent over 200,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

We support the International Accounting Standards Board (IASB) project to revise the Conceptual Framework and agree that the purpose of the current project should be to address gaps and areas where problems are being encountered in practice. We agree that the areas identified by the Board in the current discussion paper do include many of the areas of most pressing need.

However, we are concerned that the IASB's approach, as set out in the ITC, is not suitably aspirational or forward looking. We consider that it is over-focused on solving current issues very narrowly and on providing conceptual justifications of existing practices. This has been at the expense of developing sound conceptual arguments that can form a conceptual foundation for directing the future of financial reporting. This approach is most apparent in the chapters on the distinctions between liabilities and equity, measurement, OCI and presentation and disclosure. While we recognise that the discussion paper proposes a pragmatic approach to meet a tight timetable, we would prefer that these issues were addressed more thoroughly, even at the expense of the 2015 deadline.

One consequence of this narrow approach is that a number of conceptual issues have been delegated to standards level projects, rather than forming part of the Conceptual Framework project, where we consider they are more suited. This would particularly apply to issues of performance reporting and presentation and disclosure. We believe that this approach will continue to result in inconsistent standard setting until the issues at the heart of these topical discussions are resolved at a conceptual level.

Another consequence of the approach taken is that some of the fundamental issues that we believe lie at the heart of many of the issues the profession struggles with today are not considered in any conceptual way, Examples would be from whose perspective reports should be prepared, the concept of capital that underlies these reports and how best to report performance. Given, that the Conceptual Framework tends to be updated infrequently, we do not consider that these issues can wait until a future framework review, as inconsistency within the standards will continue well into the future if they remain unresolved.

We would encourage the IASB to reflect on how its development of the Conceptual Framework might benefit from recent publications like the AASB Essay 2013-1, Rethinking the Path from an Objective of Economic Decision Making to a Disclosure and Presentation Framework and the AASB Occasional Paper No. 1 Liabilities – the neglected element which focus on several of these wider issues.

We are also concerned that the IASB's intentions to limit the Conceptual Framework to financial statements will give the document limited relevance to financial reporting. We believe it is essential to consider financial reporting in its wider context if the needs of users are to be more fully understood as these will then inform the decisions taken in order to ensure that the objectives of financial reporting are achieved. As such, greater acknowledgement of the wider issues associated with financial reporting which are also underpinned by the Conceputal Framework needs to be made during its revision process. In particular, greater involvement with the work of International Integrated Reporting Committee on its integrated reporting project could benefit both projects.

Similarly, we are also concerned that there is insufficient indication in the discussion paper about the level of collaboration that is being undertaken with the International Public Sector Accounting Standards Board (IPSASB) given that they are also working in this area. We believe a joint project is likely to be of far greater benefit to the profession as a whole than separate individual frameworks. It is absolutely critical that the IASB and IPSASB work together on these issues in order to create a framework that is, as much as practical, widely applicable and sector neutral. This will allow the IPSASB to continue its approach of modifying IFRS for public sector use easily, so promoting the goal of global standard setting. It would also provide national standards setters such as Australia with a framework that they can continue to use to support their reporting frameworks for 'non-profit' entities as well as the 'for profit' sector.

Our detailed responses to the questions posed in the ITC are contained in the attached appendices. If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au or Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au.

Yours sincerely

Alex Malley
Chief Executive
CPA Australia Ltd

Lee White
Chief Executive Officer
Institute of Chartered Accountants Australia

Appendix 1

Section 1 Introduction

Question 1
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; and**
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 that departure, in the Basis for Conclusions on that Standard.**

Do you agree with these preliminary views? Why or why not?

(a) We do not agree with the Board's preliminary view that the primary purpose of the Conceptual Framework is for the IASB's use. We believe that the purpose of the Conceptual Framework is to articulate clearly what the profession as a whole considers are the principles underlying high quality financial reporting. The current Conceptual Framework has brought together the historical developments in accounting theory into a framework that is both recognised and used. While it is widely acknowledged that it is incomplete and out of date, it does deal with many of the fundamental issues involved in the identification , recognition, measurement and presentation and disclosure of economic phenomena, as well as who should report and what they should report.

All members of the profession, be they preparers, auditors or regulators, understand and use these concepts on a regular basis to ensure they deliver high quality financial reporting outcomes to users. Users, refer to the concepts to help them make sense of the information communicated to them through the financial statements. Specifically the framework is referred to when:

- Dealing with transactions for which there are no specific standards or where the application of the standards is unclear. While IFRS is reasonably comprehensive, the rate of growth in transaction structuring and the necessarily slow response time the Board can have to emerging issues makes a strong Conceptual Framework essential
- Making sense of Board decisions on specific issues and understanding and applying the decisions in the standards to specific circumstances without the need to resort to the IFRS Interpretations Committee
- Forming the basis on which the current generation and future generations of the profession can educate themselves on the principles on which financial reporting is founded and which necessarily underlie principles based standards.

To that end, users have many of the same expectations about the content of the framework that the IASB does. As a result, the deficiencies in the current Conceptual Framework are well known and have resulted in calls for the Conceptual Framework to be a high priority project going forward.

The IASB Conceptual Framework should strive to be complete and explicit. Its importance is already recognised by the hierarchy of requirements in IAS 8 *Accounting policies, changes in accounting estimates and errors.* This standard points preparers and users to refer to and consider the applicability of the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Conceptual Framework in the absence of a specific standard. If achieving this goal means that the project needs to extend beyond its 2015 timetable then this will be a small price to pay for resolving the major issues that are of concern to the profession and render financial reports difficult for users to understand.

(b) We agree that while a Conceptual Framework should be aspirational, it is not and should not be designed to address every circumstance. Therefore, we agree with the Board's preliminary view that a departure from it when setting standards should be permissible. However, such decisions should not be taken lightly. Ideally, the Conceptual Framework should clearly identify factors that the IASB should refer to when choosing to apply, at a standards level, an approach that is different from the Conceptual Framework. We believe that responding to the demands of the framework's qualitative characteristics of information, subject to a cost / benefit analysis, are an acceptable reason for departing from the framework and should be clearly envisaged as such in the framework.

Where the Board identifies the need for departures, the IASB should consider and communicate its justifications for that decision and also its view on the effect that decision has on its Conceptual Framework document. If the Board is of the view that the framework might need further development, then the timeframe and due process it proposes to undertake in order to rectify any resulting concerns (which should be rare) should also be communicated.

Section 2 Elements of financial statements

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?

(a) We agree that the revised definition of an asset will ensure focus is better directed to the rights contained within the assets rather than the economic benefits attached to those rights. We agree that the term 'present' is a useful addition to the definition to ensure symmetry with the liability definition. We also agree with retaining the term "past events" to ensure adequate focus is placed on the need to identify when or how the resources came to be controlled in order to ensure it is correctly recorded.

(b) We agree that the revised definition of a liability will ensure focus is better directed to the inherent obligations that have been incurred by an entity. We also agree to retain the "past events", to ensure that adequate focus is placed on the need to identify when or how the obligations were incurred in order to ensure it is correctly recorded.

(c) We agree with the definition of an economic resource and its use in the asset definition to better encompass the economic benefits within assets.

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 paragraphs 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?

(a) We agree with the removal of the term "expected" from the definition of an asset. We consider that an asset need only be capable of producing inflows in order to be defined as an asset and consider that matters of uncertainty that underlie valuation are best dealt with by having separate specific asset recognition criteria rather than confusing these issues within the definitions.

(b) and (c) We do not agree that, at this time, it is appropriate to remove the probability thresholds for existence uncertainty or recognition uncertainty from the asset recognition criteria. While conceptually we can see the merits of this approach, we are concerned it places too much emphasis on as yet poorly developed measurement concepts to cope with assets of uncertain value. Time spent identifying all types of assets that are capable of producing inflows is likely to far outweigh the costs of producing the information. This may cease to be the case once we have clearly resolved the conceptual issues surrounding concepts of capital and appropriate measurement bases. However, currently effective resolution of these issues is not clear and so "probability" should be retained until such time as this occurs.

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?

We consider that it is appropriate to retain the existing definitions of income and expense based on the asset and liability definitions. Changes in these should then drive the information reported in the income statement. However, we consider that more work needs to be done within the framework to develop effective performance reporting concepts. Perceptions exist that the emphasis on assets and liability changes impairs the way performance is both recorded and reported and these perceptions damage the credibility of financial reporting.

Concepts such as OCI, the differences between income and gains, and expenses and losses and the relationships between the income statement, cash flow statement and balance sheet are not well drawn together by the current framework and have resulted in presentation and disclosure standards which demonstrably do not meet user's needs. Clear objectives for financial reporting in this area need to be established so that the resulting decisions about presentation and disclosure logically follow from these principles. We also believe these issues need to be dealt with at a conceptual level first, before or at least in conjunction with current plans to revise IAS 1 and IAS 7 (see our comments on the questions in section 7, questions 19-21).

We do not consider that defining any of the additional items identified in paragraph 2.52 as "elements" of the financial statements is appropriate. We consider they are only subgroups of the four identified elements. However, they are useful for understanding the breadth and depth of the main concepts. Therefore, in the same way the current framework identifies categories of income and expense, we consider that the terms "contributions to equity", "distributions of equity" and "transfers between classes of equity" would benefit from discussion. This is because they are subsets of an undefined term (equity) and provide useful means of breaking up the information that is contained within that term.

Section 3 Additional guidance to support the asset and liability definitions

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?

We agree with including constructive obligations as liabilities. We consider that entities incur a range of obligations that are not necessarily legally enforceable but are nonetheless obligations of their ongoing business activities. Recognition of constructive obligations provides useful information to users of the financial statements. We also agree that clarity in the area of distinguishing constructive obligations from economic compulsion is vitally important to assist in the application of the professional judgment that will be necessary when this approach is adopted. We therefore support the inclusion of additional guidance in the Conceptual Framework on this issue.

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 support view 2 – that a present obligation must be practically unconditional in order to qualify as a liability. We consider that users are interested in more than just the strict legal liabilities of the entity, especially given that going concern is an underlying assumption. Therefore, we consider it appropriate to recognize some conditional obligations. However, it is impractical to attempt to recognise liabilities subject to all types of conditions. Therefore, we consider the best dividing line would be obligations which the entity has no practical means of avoiding if it is to remain economically viable.

Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

We support the inclusion of additional guidance into the Conceptual Framework on the concepts of economic resources and control to support the definition of assets. We consider these concepts are fundamental to the exercise of professional judgment associated with implementing the asset definition.

For the same reason, we also support inclusion of guidance on the concept of transfer of an economic resource for liabilities and the inclusion of material on dealing with rights and obligations within both executory and other contracts.

Section 4 Recognition and derecognition

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?

We do not agree that the Conceptual Framework's recognition criteria should be expressed in terms of "everything except what the IASB decides". We believe this focus on the IASB's role fails to produce criteria that are robust enough to provide guidance to financial statements users and preparers when dealing with new situations and transactions.

However, we do agree that the recognition criteria need to have as their objective to provide relevant information so that it can be measured in a way that faithfully represents its value to users of financial statements.

We also believe the probability criteria needs to be retained as part of the recognition criteria to provide a practical basis upon which to make recognition and derecognition decisions. We consider this is necessary until such times as we have clear principles relating to, measurement as discussed in questions 11-15.

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?

We agree that the concept of derecognition should be explicitly addressed in the framework to ensure the results of the economic phenomena that has caused the asset or liability to no longer meet the recognition criteria is appropriate. We agree that control should be the criterion used for derecognition in the same way it is used to assess asset recognition, as the process needs to be a mirror image of recognition. However, we do not agree that the issue of partial derecognition should be a standards level decision.

The framework needs to be robust enough to deal with a variety of derecognition scenarios – not just the ends of the spectrum. It, therefore, needs to contain clear principles relating to the issues involved in partial derecognition that standard setters and others can then use to help make appropriate assessments about the loss of control. The principles should be based on the notion that the entity should not continue to recognise the original asset or liability once control is lost but should separately recognise a new asset/ liability based on the rights/ obligations retained.

Section 5 Definition of equity and distinction between liabilities and equity instruments

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 *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.**
b. **the *Conceptual Framework* 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 paragraph 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?

(a) We agree that equity should continue to be defined as the residual interest in the assets of the entity after deducting all its liabilities. We consider that assets and liabilities are the principal building blocks for reporting economic phenomena and that the claims an entity's owners can reasonably expect to have on its assets are best reflected by using this definition.

(b) We agree that the definition of a liability should be used to distinguish liabilities from equity and that, in consequence, obligations to issue equity instruments are not liabilities and neither are obligations that will arise only on liquidation of the reporting entity. Attempting to define equity leaves open the possibility that something may fit neither definition, which we do not consider is helpful to the reporting of useful information. However, given the difficulties associated with some of the more complex financial instruments, we believe the CF should identify the main types of equity that will arise if the strict obligation approach is adopted as an indication of how the definition impacts equity elements.

(c) We do not support the idea of remeasuring classes of equity via the statement of changes in equity. We prefer to adopt the "entity perspective" for financial statements and therefore do not believe that the financial statements should attempt to provide detailed information on how the entity's resources might be distributed to owners in this way. The proposals set out in the discussion paper create allocations and resulting wealth transfers that are artificial measures of equity that are supported by changes in assets and liabilities. We do not consider these provide meaningful information to users. The use of the current approach on non-controlling interest accounting is also problematic as there are conceptual difficulties with this approach when adopting our preferred entity perspective. We recommend that further work is done in order to identify the main types of equity that will arise if the strict obligation approach is adopted, what information users might need about these and how best to communicate this.

(d) We do not agree with the notion of treating the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. We believe that the "entity perspective" rather than the "parent perspective" is a more appropriate framework for financial statements and so an equity classification is not essential if it is not appropriate in the circumstances. Should a particular type of organisation demand equity presentation for particular instruments that might otherwise be liabilities (e.g. cooperatives and puttable interests) we accept that permitting this at a standards level in response to the needs of users would be a reasonable circumstance to depart from the Conceptual Framework in this area.

Section 6 Measurement

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.**
- **b.** **a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;**
- **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;**
- **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.**
- **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**
- **f.** **the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.**

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?

We agree with the IASB on the need for a clear measurement objective and associated discussion to be included in the Conceptual framework.

Paragraph 6.10 of the Conceptual Framework describes the objective of measurement "is to contribute to the faithful representation of relevant information about the resources of the entity, claims against the entity and changes in resources and claims, and about how efficiently and effectively the entity's management and governing Board have discharged their responsibilities to use the entity's resources". Paragraph 6.6 notes that the objective of financial reporting along with the fundamental qualitative characteristics of useful financial information is the basis that underlies the measurement concepts articulated in the Conceptual Framework. It proposes that relevance and faithful representation are the most important factors when choosing a measurement base. The enhancing qualitative characteristics of understandability, verifiability and comparability are less important. Further, paragraph 6.16 states "…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 the entity's future cash flows".

We believe this section of the Conceptual Framework would be improved by expressing the measurement objective aspirationally as opposed to the way the objective is expressed in preliminary view (a) above. Consequently, in this section the IASB should express clearly its view on the issues of the business enterprise and the concept of capital. In the case of the former, does it support a proprietary or entity view? In the case of the latter does it support a financial or physical concept of capital? We would then like the measurement section to develop the link between the ideal concept of capital, the ideal concept of capital maintenance and the resulting selection of a measurement basis that is the consequence of applying those concepts.

For example, the Board may determine that in the course of determining the appropriate measure for profit, the ideal concept of capital maintenance is the maintenance of financial capital in money terms. It would therefore follow that the appropriate measurement base is historical cost. Alternatively, the Board may determine that the ideal concept of capital maintenance is:

- the maintenance of financial capital in real terms with the resulting selection of entry price as a measurement base or
- maintaining the productive (operating) capacity of the entity with the resulting selection of an exit price as the appropriate measurement base.

Moreover, we think it appropriate that the measurement discussion include a reference to an asset or a liability and its contribution to the entity's future cash flows. The discussion here is also relevant to the discussion on capital maintenance at section 9.

While we consider that the Conceptual Framework discussion on this topic must be aspirational, we also think it must be practical. We therefore agree with the IASB's preliminary view in (b) above, that a single measurement basis is not likely to be appropriate in all circumstances. Therefore, we agree with the IASB that the Conceptual Framework should clearly identify factors that should be referred to when choosing, a measurement base to be applied to particular assets and liabilities at a standard level. This can then underpin any decision made on a base that is different from the one dictated by its ideal capital concepts. We believe that the Conceptual Framework's qualitative characteristics of relevance, faithful representation, understandability, verifiability and comparability subject to a cost-benefit analysis are suitable for this purpose. We also agree that the discussion in this area should explicitly consider the impact of the choice on both the profit and loss and balance sheet as set out in preliminary view (c) above as well as cost/ benefit (preliminary view (f) and so we support both these views . We also consider that it should also state that, while a mixed measurement model may be inevitable, minimising the different models being used is also fundamental to ensuring the relevance and reliability of reported information (preliminary view (e)) and so we support this view.

Paragraph 6.17 states that the selection of a measurement base for a particular liability should depend on how the entity will settle or fulfil that liability. We understand the characteristics of a liability refer to the amount and timing of future resource flows and the uncertainty related to the amount and timing of those flows, including non-performance risk (being the possibility that the obligation will not be fulfilled by the entity). Accordingly, as we do not support the IASB proposition that fulfilment value excludes non-performance risk we do not support its use as a basis for the selection of a measurement base for a particular liability. We therefore do not support preliminary view (d).

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

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.

We do not support the preliminary views and the related proposed guidance.

In our response to Question 11 above we explained our view that this section of the Conceptual Framework should address measurement in a comprehensive, aspirational and practical way that includes ideal capital concepts. We expressed our support for the IASB to use the Conceptual Framework qualitative characteristics of relevance, faithful representation, understandability, verifiability and comparability subject to a cost-benefit analysis as factors to be referred to by it in choosing to apply at a standards level to particular assets and liabilities a measurement basis that is different from its ideal capital concepts.

As the Conceptual Framework does not express aspirational ideal capital concepts the approach expressed in the preliminary views can be best described as one which categorises assets by measurement base subject to the asset's relationship to cash flows. We think what is described here might be the decisions made at a standards level. We do not think detail of this type is appropriate at the level of a Conceptual Framework.

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

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.

We do not support the preliminary views and the related proposed guidance.

Our responses to Questions 11 and 12 above are relevant here. We have explained the need for the Conceptual Framework to address measurement in a comprehensive, aspirational and practical way that included ideal capital concepts. Further, it is our view that the Conceptual Framework should specify qualitative characteristics that would be referred to by the IASB in choosing to apply at a standards level to particular assets and liabilities a measurement basis that is different from those ideal capital concepts.

As the Conceptual Framework does not express aspirational ideal capital concepts the approach expressed in the preliminary views can be best described as one which categorises liabilities by measurement base subject to the liability's relationship to cash flows. While this approach might describe possible decisions at a standards level we consider it is inappropriate for a Framework.

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 (i.e. the asset or the liability is highly leveraged).**

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

We do not support the preliminary views for the reasons we have stated and restated in our responses to Questions 11, 12 and 13.

Question 15
Do you have any further comments on the discussion of measurement in this section?

We have no further comments on the discussion of measurement in this section.

Section 7 Presentation and disclosure

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 *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and**
- **b. other work that the IASB intends to undertake in the area of disclosure (see paragraphs 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 the Financial Statement Presentation project;**
  - **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*.

We do not agree with the context in which the IASB's preliminary views, as expressed here, have been developed. We do not support the idea in preliminary view (a) that the Conceptual framework is primarily for use by the board, as set out in our response to Question 1. Further, we do not support the view that the content of this section should be developed in light of the other work on presentation and disclosure being done which might assist the IASB in developing and revising standards in this area (preliminary views (b)). We believe that the Conceptual Framework is the appropriate place to address presentation and disclosure objectives and those improvements in financial reporting are more likely to result from the incorporation of these projects into the Conceptual Framework as opposed to trying to progress them separately. We have similar concerns about materiality.

It is our view that this section should be about establishing terminology and the decisions an entity makes on how it will communicate general purpose financial statement information.

Accordingly, we consider it is communication that is the selection, location and organisation of information. That information may be presented on the face of the financial statements or in the notes to the financial statements. We think the proposal in paragraph 7.11 to modify terminology that is well understood in the context of financial statement is unhelpful and will cause unnecessary confusion.

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?

No we do not agree with this approach. We believe the Conceptual Framework would benefit from the inclusion of additional guidance on materiality. The topic is of fundamental importance to recognition and presentation and disclosure issues and addressing the issues identified in paragraph 7.46, which are of concern in practice, would be helpful.

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?

We agree that the Conceptual Framework would benefit from clearly stated communication principles about the selection, location and organisation of information in financial statements. These would emphasise the importance of financial reports as a communication tool for the entity and set the scene for the subsequent presentation and disclosure discussions. We agree that the communication principles being proposed address the fundamental issues in this area.

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

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?

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 amending Standards?

We consider the Conceptual Framework should express a performance measure objective. Without a performance measure objective it is difficult to identify what results should be reported and the purpose of and need for a distinction between net income and other comprehensive income (OCI). We expect this objective would be informed by understanding the measures that investors use in their analysis of financial performance. We understand profit or loss is a key measure and we agree that the Conceptual Framework should require profit or loss to be presented as a total of subtotal on the statement(s) of profit or loss and OCI.

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 recognised subsequently in profit or loss, i.e. 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?

If you do not agree, how would you address cash flow hedge accounting?

In our response to Question 19 above we stated our reasons why the Conceptual Framework should express a performance measure objective. Without a clear objective it is difficult to distinguish between net income and OCI . It is also difficult to identify how to determine different measures (be that as totals, subtotals or independently of that process as for example is done with earnings per share) and their presentation.

Moreover, a performance measure objective may address the issue of recycling. There is no clarity around the current approach in IFRS that requires recycling for some items but not for others and in the absence of this clarity the concept is difficult to support conceptually. . Our preference is for the Conceptual Framework to require either:

- all items initially recorded in OCI to be eventually recognised within net income; or
- no recycling of items initially recorded in OCI.

However, we do recognise that it might not be possible for the Conceptual Framework to express a single view on recycling and instead direct that it is an issue that is best addressed at a standards level.

Question 21
In this Discussion Paper, 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 Discussion Paper

We do not think it appropriate for the Conceptual Framework to include this level of detail.

Section 9 Other issues

Question 22
***Chapters 1 and 3 of the existing* Conceptual Framework**

Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* 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 *Conceptual Framework* 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*.

We agree with the IASB that it is not necessary to fundamentally reconsider the content of these two published chapters. However, we do believe that finalising the conceptual framework project will require a review of the two published chapters in light of the work on the material described in the Discussion Paper. This will ensure that concepts in the latter chapters, which depend on or use concepts from the earlier chapters, are clearly and explicitly linked. A review of this type also enables the entire Conceptual Framework to be subjected to a contemporary holistic evaluation before its finalisation.

Question 23
Business model
The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper 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?

Paragraph 1.35 states "the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to users of financial statements in making decisions about providing resources to the entity". The paragraph also notes the usefulness of financial information is enhanced if it is comparable.

We agree with the preliminary view that a consideration of how an entity conducts its business activities might be useful in the development of individual standards. Doing so may enable financial statements to be made more relevant to users. In this context, we think it would be useful for the Conceptual Framework to include some discussion of the effect of entities reflecting their different business models on the production of information that is comparable.

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?

We agree that the unit of account should be based on the qualitative characteristics of useful information and we think it would be useful for the Conceptual Framework to express that. We also agree with the IASB that the unit of account will normally be decided at a standards level. However, because the concept is such a fundamental one, impacting recognition, measurement, presentation and disclosure decisions, we argue that it would be helpful to include guidance on the concept and its practical application included in the framework.

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?

No, we are not aware of 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.

In our response to Question 11 above we stated our view that the Conceptual Framework should articulate an ideal concept of capital maintenance and its relationship to the ideal measurement base. Accordingly, we do not support the proposal that leaves the existing descriptions and discussion of this issue largely unchanged until such time as any project on accounting for high inflation indicates a need for change. We think this approach suggests a lack of understanding about the fundamental role a capital maintenance concept has within the accounting framework. We also consider that our current difficulties with profit measurement and OCI, which have issues of capital maintenance at their root clearly indicate a pressing need to resolve these issues.

Appendix 2

AASB Specific Matters for Comment:

1. **Are there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views, particularly any issues relating to:**

   (a) not-for-profit entities; and
   (b) public sector entities, including the implications of the preliminary views for GAAP/GFS harmonisation?

   We believe it is absolutely critical that the IASB and the International Public Sector Accounting Standards Board work together to create a framework that is, as much as practical, widely applicable and sector neutral. This will provide Australia with a framework to use to support the financial reporting of 'non-profit' entities from the public and private sector as well as the 'for profit' sector. We are not aware of any other issues arising from the ITC specifically pertaining to not-for-profit entities and public sector entities.

2. **Overall, would the preliminary views result in financial statements that would be useful to users?**

   Yes, apart from where our comments above indicate otherwise, we believe the proposals would result in financial statements that would be more useful to users.

3. **Are the preliminary views in the best interests of the Australian economy?**

   Subject to our comments made in this submission, we believe the proposals are in the best interests of the Australian economy.

4. **Unless already provided in response to specific matters for comment 1 – 3 above, are the costs and benefits of the preliminary views relative to the current treatments, whether quantitative (financial or non-financial) or qualitative?**

   Subject to the comments made in this submission, we do not expect there to be any negative consequence from the implementation of the proposal.