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EXTRACT FOR AASB MEETING

11 February 2014

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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UNITED KINGDOM

Dear Hans

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

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on the above named Discussion Paper (DP). In formulating its comments, the AASB considered the views received from Australian constituents via comment letters and forums. The comment letters received are published on the AASB's website.

The remainder of this submission has numbered paragraphs for ease of cross-referencing between related comments.

Brief overview of submission

- 1 The AASB strongly supports the IASB undertaking its Conceptual Framework project but has serious concerns regarding:
 - (a) the preliminary views in the DP on some core issues; and
 - (b) the insufficiently conceptual approach taken to the analysis of some issues.

Strong support for the IASB undertaking the project

- 2 The AASB appreciates the IASB's efforts in issuing the DP and strongly supports giving a high priority to the review of its Conceptual Framework. The AASB and the Asian-Oceanian Standard-Setters Group identified the Conceptual Framework project as the highest priority project the IASB should undertake, in responding to the IASB's Request for Views: *Agenda Consultation 2011* (July 2011). The AASB also congratulates the IASB on articulating, and seeking timely feedback on, a number of conceptual issues in the DP, at this relatively early stage of the reactivated project.

Support for updating concepts for latest IASB thinking and filling in gaps

- 3 The AASB supports some of the IASB’s preliminary views regarding updating the IASB Conceptual Framework to reflect the IASB’s latest thinking on conceptual issues, and some of the IASB’s preliminary views on how to fill in gaps in the existing Conceptual Framework. For example, it supports the IASB’s preliminary views that:
- (a) the definitions of an ‘asset’ and a ‘liability’ should be amended to focus on economic resources and obligations, rather than inflows and outflows (respectively) of economic benefits that each economic resource or obligation may generate;
 - (b) an ‘economic resource’ should be defined as “a right, or other source of value, that is capable of producing economic benefits” (paragraph 3.4 of the DP), which would confirm a shift away from traditional notions of accounting for physical objects and toward accounting for different rights composing economic resources. This shift should be particularly helpful over time in addressing derecognition of components of assets (e.g. non-financial assets);
 - (c) the Conceptual Framework should not retain the recognition criterion that an asset or a liability must have a cost or value that can be measured with reliability;
 - (d) the Conceptual Framework should include derecognition criteria for assets and liabilities, and that these criteria should be neutral (i.e. symmetrical with the recognition criteria)¹; and
 - (e) a ‘strict obligation approach’ should be taken to distinguishing liabilities and equity, including classifying as liabilities only present obligations to transfer economic resources².
- 4 The AASB also supports the IASB’s intention not to fundamentally reconsider Chapters 1 and 3 of the Conceptual Framework for the reasons given in paragraph 9.2 of the DP. In particular, the AASB:
- (a) considers it would be unnecessary and inappropriate to amend Chapter 1 to give greater emphasis to stewardship;
 - (b) considers it would be inappropriate to reintroduce the qualitative characteristic of reliability to Chapter 3; and

¹ However, the AASB has concerns about the narrow scope of the IASB’s preliminary view on the general approach to derecognition—see comments in paragraphs B43 – B49 of Appendix B below.

² However, the AASB has a different view to that expressed in the DP regarding how in concept to identify a present obligation: see the AASB’s comments on Section 3 of the DP in paragraphs B35 – B42 of Appendix B below.

- (c) would strongly disagree with reintroducing the qualitative characteristic of prudence to Chapter 3.

Serious concerns

- 5 The AASB has serious concerns with a number of the IASB's preliminary views, including in relation to some core issues. These serious concerns are discussed in paragraphs 6 – 26 below.

Serious concerns of a general nature

- 6 The most serious concerns of a general nature that the AASB has with the DP are that:
- (a) the preliminary views addressing certain gaps in the Conceptual Framework are fundamentally inadequate, because:
 - (i) they are more in the nature of standards-level rules or a catalogue of current conventions than concepts. For example, the sections of the DP on measurement, and presentation and disclosure, exhibit those characteristics (see elaboration of this concern, and other examples, in paragraphs A1 – A6 of Appendix A below); and
 - (ii) the DP argues a number of issues should be dealt with only at a standards level without conceptual underpinnings to guide those standards-level decisions. Examples of such issues are whether and how to derecognise an asset or a liability if the entity retains a component of that asset or liability after a transaction, the classification (as liabilities and/or equity) of particular puttable financial instruments, and concepts of capital maintenance (see paragraph A8 of Appendix A below for a more extensive list of such examples).

A lack of conceptual elevation is a key weakness of the DP, because a major goal of the IASB's limited scope project to update its Conceptual Framework (as indicated in the second paragraph of the DP's summary and invitation to comment) is to fill in gaps in the concepts. Therefore, a revised Conceptual Framework reflecting the preliminary views would be highly inadequate as a basis for assisting the IASB in making decisions about difficult standards-level issues that are coherent across the suite of IFRSs and foster reporting high quality information that assists investment, credit and other economic decisions;

- (b) some preliminary views represent a backward step from the existing Conceptual Framework. This is because the existing Conceptual Framework only identifies economic phenomena as elements of financial statements, whilst some preliminary views would involve an entity recognising in its financial statements things (accounting responses) that are not economic phenomena, at least not in the period in which they are recognised. For

example, see the comments on recycling and other examples of this concern in paragraph 26, and paragraphs A10 – A14 of Appendix A, below; and

- (c) for various issues, the preliminary views include exceptions to the draft concepts. This strongly suggests the concepts for those issues are insufficiently robust or inappropriately interpreted in relation to particular transactions, events or circumstances. For example, the DP includes a preliminary view that the Conceptual Framework should use the definition of a liability to distinguish liabilities from equity instruments, using the ‘strict obligation approach’ (paragraphs 5.34(a) & (b), and 5.37(a) & (b) of the DP). However, the DP also includes a preliminary view that, 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, e.g. this might be appropriate for particular puttable instruments giving holders a residual interest in the entity’s net assets (see elaboration of this comment, and other examples, in paragraphs A15 – A17 of Appendix A below).

7 In expressing these and other concerns, the AASB acknowledges that the project’s aim (as stated in the DP) is not to undertake a fundamental re-think of the existing concepts, but instead is to build on the existing IASB Conceptual Framework by completing, refining and updating it. The AASB also acknowledges that the DP indicates:

- (a) it is not intended to provide a comprehensive indication of the views that might be contained in an Exposure Draft (ED) of a complete revised Conceptual Framework; and
- (b) the IASB left some issues unresolved in the interests of issuing the DP quickly to obtain timely feedback on its preliminary views.

8 In that context, the AASB’s focus in this submission is on the unaddressed (or unsatisfactorily addressed) issues in the DP that need to be resolved in developing the ED.

9 The AASB considers that, in view of the fundamental importance of the Conceptual Framework to the development and review of IFRSs and to assisting preparers of financial statements in applying judgement in the absence of a requirement of a standard dealing with a specific matter, the IASB should take the time necessary to deal with most, if not all, substantive issues currently identifiable as belonging in a comprehensive revised Conceptual Framework. This might involve more time than the IASB initially envisaged taking to complete the revised Conceptual Framework. However, if so, the AASB considers it is more important that the revised Conceptual Framework is comprehensive and coherent rather than issued according to a self-imposed timeline. Since that timeline was established, greater insights have been gained into the breadth, difficulty and complexity of the issues that need to be addressed. The AASB observes that a comprehensive and coherent Conceptual Framework should, over time, save the IASB time in developing and revising IFRSs because unresolved conceptual debates would not need to be addressed, repeatedly (and potentially inconsistently), at a standards level.

Serious concerns regarding specific sections of the DP

- 10 The following serious concerns of the AASB regarding specific sections of the DP are elaborated on in Appendix A. Their order follows the order in which the related text of the DP is presented, rather than connoting a ranking of their importance to the AASB.

Section 6—Measurement

- 11 The AASB strongly disagrees with the preliminary view that a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements. The DP does not explore the possibility that a single measurement basis (or model) could allow for practical standards-level compromises while providing consistent conceptual direction in improving measurement. Rather, it compromises the economic meaning of the amounts depicted for assets and liabilities (and changes therein) by inappropriately elevating measurement methods to the status of measurement attributes. The AASB considers that the measurement model it recommends is capable of practical implementation and is far more justified by the academic accounting literature on ‘value relevance’ than the approach proposed in the DP. The AASB’s preferred measurement model is discussed in paragraph 17 below and paragraphs B126 – B141 of Appendix B below. Appendix C below illustrates how that model might be modified for application in IFRSs without radical changes to those Standards at this stage. Paragraphs A36 – A37 in Appendix A below discuss the findings of academic studies on the ‘value relevance’ of current values and, in particular, of the type of current value the AASB considers conceptually ideal.
- 12 The AASB agrees with the measurement objective in paragraph 6.35(a) of the DP. The AASB also considers that, consistently with paragraph OB3 of the IASB Conceptual Framework, a key objective of measurement concepts should be to identify measurement bases or attributes that provide the most useful information for predicting the entity’s future cash flows³.
- 13 The AASB considers that, in addition to specifying the measurement objectives referred to in paragraph 12 above, the Conceptual Framework should include measurement concepts that (if applied at a standards level) would result in measurements possessing the following qualities:
- (a) the amounts can meaningfully be added, subtracted and compared; and
 - (b) their economic significance, individually and collectively, is capable of being understood.⁴

³ However, this does not mean the measurements should be estimated present values of the future cash flows specifically attributable to each asset and liability being measured (see paragraphs B100 – B108 of Appendix B below for an explanation).

⁴ The AASB acknowledges that paragraph 6.16 of the DP includes similar comments regarding the merits of measuring all assets and liabilities on the same basis. The AASB does not find convincing the counter-arguments in paragraph 6.13 of the DP, which explain the IASB’s preliminary view not to

- 14 To achieve the goals in paragraph 13 above, the measurements must have a common property. This, in turn, would require identifying an ideal concept of ‘wealth’, having regard to the common information needs of users, rather than presuming a mixed measurement model in concept. The wealth embodied in an entity’s assets is their capability to contribute (directly or indirectly) to generating cash inflows to the entity; the reduction in wealth embodied in an entity’s liabilities is the reduction they cause in the entity’s capability to generate cash inflows. An explicit concept of wealth articulates the meaning of ‘economic benefits’ in the definitions of an asset and a liability and indicates the entity’s capability to interact with its economic environment in pursuing its objectives. Because economic benefits include different properties, identifying an ideal concept of wealth involves choosing which of those properties provides the most useful information to meet the common information needs of users in making resource allocation decisions. In short, it involves specifying the *nature* of the wealth embodied in an entity’s assets and liabilities that is most useful for achieving the objective of financial reporting.
- 15 As mentioned in paragraph 14 above, the wealth embodied in an entity’s assets and liabilities could be specified in different ways. The concepts of wealth generally debated in the academic accounting literature are:
- (a) *invested money capital*⁵, which includes:
 - (i) for recognised assets, the original dollar amounts invested in them that have yet to be consumed; and
 - (ii) for liabilities, the unearned portion of the amounts originally paid by customers for promised goods and services, plus unrepaid amounts of previous borrowings⁶;
 - (b) *operating capability*, which represents an entity’s ability, at any given time, to carry out its activities at the scale determined by its then-existing resources, both monetary and non-monetary. Using an operating capability concept of wealth, the entity’s recognised economic resources and present obligations, and recognised changes in those resources and obligations resulting from the entity’s operations, are measured in terms of the specific prices currently relating to them, i.e. their current cost. Specifically:
 - (i) recognised assets are generally measured at the amounts the entity would currently need to pay to acquire them; and

recommend measuring all assets and liabilities on the same basis. The AASB’s reasons for disagreeing with paragraph 6.13 of the DP are explained in paragraphs A18 – A21 of Appendix A below.

⁵ Strictly speaking, this concept of wealth is the remaining or unconsumed amount of the entity’s invested money capital. However, consistent with the academic accounting literature, this submission refers simply to ‘invested money capital’ to encapsulate that notion.

⁶ These amounts comprise the entity’s *nominal* money capital; if the concept of capital adopted were the current purchasing power of invested money capital, the amounts of capital originally invested would be adjusted for subsequent changes in the general purchasing power of money.

- (ii) recognised liabilities are measured at the current cost of the assets the entity expects to consume in extinguishing those liabilities (e.g. by providing promised goods and services to customers). In the case of outstanding loans, these amounts would be the present value of loans discounted at a current borrowing rate; and
- (c) *current cash equivalents commanded*, which includes:
 - (i) for recognised assets, the net amounts for which they could be sold in an orderly transaction⁷ on the measurement date under current market conditions; and
 - (ii) for recognised liabilities, the amounts for which they could be redeemed, or transferred to another entity, in an orderly transaction on the measurement date under current market conditions.

Each of these alternative concepts of wealth underpins each of the three measurement bases (other than ‘present value’) described in paragraph 4.55 of the IASB Conceptual Framework, namely, ‘historical cost’, ‘current cost’ and ‘realisable (settlement) value’, respectively. The AASB’s evaluation of these concepts of wealth is set out in paragraph 17 below and within paragraphs B100 – B141 of Appendix B below.

- 16 To achieve the goals in paragraph 13 above, a clear articulation of the meaning of ‘economic benefits’ in the definition of an asset or a liability would be necessary. Identifying an ideal concept of wealth would also enable the economic significance of the entity’s reported economic income (i.e. change in wealth from all transactions and other events of the period, other than transactions with owners acting in their capacity as owners) to be understood.
- 17 The AASB considers that operating capability is the concept of wealth most useful for achieving the objective of financial reporting, including the provision of information useful for predicting the entity’s future cash flows⁸. The AASB considers that, for the reasons set out in paragraphs B119 and B128 of Appendix B below:
- (a) the current market entry prices (current costs) of assets provide the most relevant information for predicting future cash inflows from future sales of the entity’s products and future cash outflows from replacing assets;
 - (b) the current costs of depreciation/amortisation and goods sold provide the most relevant information about the sustainability of the entity’s margins and business model, and thus the entity’s prospects for sustaining its future cash inflows; and

⁷ For example, if the asset being measured were an item of real estate, it would be assumed that an adequate period of marketing to obtain the best available price had been completed before the measurement date.

⁸ Consistently with paragraph OB3 of the IASB Conceptual Framework, the AASB argues in paragraph 12 above that measurement concepts should identify the most useful information for predicting the entity’s future cash flows.

- (c) measuring liabilities at the current cost of the assets the entity expects to consume in extinguishing those liabilities provides the most relevant information for predicting the future cash outflows from settling those liabilities and similar liabilities the entity might be expected to incur in the future.
- 18 Although historical costs might provide useful information for the predictions referred to in paragraph 17 above, they would only do so when not materially different from current market entry prices. The AASB considers it is important not to extrapolate from coincidences when making general conclusions about a measurement basis or model. Thus, the AASB considers that the preliminary view that the most relevant measurements for some categories of assets are ‘cost-based’⁹ would not achieve the objective that measurements should provide the most useful information for predicting the entity’s future cash flows.
- 19 A consequence of identifying an ideal concept of wealth would be that the ideal measurement basis for a particular asset would not differ according to whether the asset is expected to contribute *directly* or *indirectly* to the generation of future cash flows. Therefore, the AASB strongly disagrees with the preliminary views in paragraphs 6.16, 6.78 – 6.80 and 6.83 of the DP, which identify different relevant measurement bases for particular assets according to whether those assets contribute *directly* or *indirectly* to the generation of future cash flows¹⁰ (see the elaboration of this comment in paragraph B90 of Appendix B below).

[Paragraphs 20 – 22 omitted from this extract]

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

- 23 The AASB strongly disagrees with the IASB’s preliminary views that:
- (a) comprehensive income should necessarily be bifurcated into profit or loss and OCI, and that profit or loss (stripped of items presented in OCI) should be treated as providing the primary source of information about an entity’s return on its economic resources; and
- (b) the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to be recycled to profit or loss in a later period (the AASB fundamentally disagrees with this preliminary view).

⁹ Which the AASB takes to mean ‘historical cost-based’: see paragraphs B93 – B99 of Appendix B below for an explanation of this.

¹⁰ These preliminary views elaborate the preliminary view in paragraph 6.35(d)(i) of the DP that “the selection of a measurement for a particular asset should depend on how that asset contributes to future cash flows”. Whilst the AASB considers that measurement concepts should reflect the principle in paragraph OB3 of the IASB Conceptual Framework that users of financial reports “need information to help them assess the prospects for future net cash inflows to an entity”, the AASB disagrees with the manner in which the DP proposes to operationalise that principle through the draft concepts set out in paragraphs 6.16, 6.78 – 6.80 and 6.83.

- 24 In relation to paragraph 23(a) above, the AASB’s key reasons for strongly disagreeing with necessarily bifurcating comprehensive income into profit or loss and OCI and treating profit or loss (stripped of items presented in OCI) as providing the primary source of information about an entity’s return on its economic resources are:
- (a) it considers that it would be conceptually inappropriate to classify continuous variables as if they were discrete. That is, binary classification of economic (‘comprehensive’) income should not be adopted, given the range of ways in which economic income could (and should) be classified with differentiated implications for predicting the entity’s future cash flows;
 - (b) the notion of OCI is not part of an integrated theory of presentation of financial performance; and
 - (c) it considers that the DP does not establish a coherent principle for determining when it is more relevant to present an item in OCI rather than profit or loss. Furthermore, it seems unlikely that such a principle could be developed.
- 25 The AASB considers that, rather than adopting a binary classification of economic (‘comprehensive’) income, principles for a multi-faceted disaggregation of economic income should be developed, which classifies items of economic income (supported by disclosures) according to their different implications for predicting the amount, timing, uncertainty and velocity of future cash flows. In making these predictions, users need information about the volume, direction, pace of change, variability and predictability of changes in the entity’s economic resources and claims on the entity’s economic resources¹¹. In this regard, the distinction between profit or loss and OCI, if made at all, should be a matter of sub-classification of items recognised once (and only once) in the statement of comprehensive income.
- 26 In relation to paragraph 23(b) above, the AASB considers that introducing recycling to the Conceptual Framework would represent a significant backward step from the existing Conceptual Framework. This is because the existing Conceptual Framework identifies as elements of financial statements only economic phenomena. Recycling would involve an entity reporting in its financial statements ‘events’ that are not economic phenomena of the period in which they are reported. It would involve recognising particular economic phenomena (inflows and outflows of economic resources) twice in one component or another of comprehensive income. Recycling those items would report as income and expenses in profit or loss items that are not inflows or outflows of economic resources (because those inflows/outflows occurred when they were previously recognised in OCI). The

¹¹ The AASB sees information useful for predicting the amount, timing, uncertainty and velocity of future cash flows as also including information about the volume, direction, pace of change, variability and predictability of changes in an array of various capacities, or ‘stocks’, that are relevant to those predictions (this relates to the comments in paragraph 21 above and the elaboration of those comments in paragraphs A42 – A43 of Appendix A below). However, in the context of disaggregating an entity’s economic income, the ‘stocks’ that are relevant are the entity’s economic resources and claims on the entity’s economic resources.

AASB would regard the weakening of the Conceptual Framework's commitment to reporting only economic phenomena affecting an entity as a serious concern.

Process and other aspects

- 27 The AASB recommends that the IASB should regard its Conceptual Framework as a living document, and thus should commit to reviewing and updating it from time to time in light of subsequent developments in financial reporting. Just as the IASB's current review of the Conceptual Framework was occasioned, in part, by developments in the IASB's thinking on conceptual issues, so is it likely that such developments will continue to occur. However, this does not mean it is unnecessary to fill the conceptual gaps of which the IASB is presently aware and capable of addressing within a reasonable timeframe [see the comments on this aspect in paragraphs 9, and D1 (in Appendix D below), of this submission].
- 28 The AASB encourages the IASB to use sector-neutral expression in the Conceptual Framework wherever possible, to help facilitate the development at some point of a common Conceptual Framework for reporting entities in all sectors of the economy, whether for-profit or not-for-profit in nature.
- 29 The AASB recommends that the IASB maximises its liaison with the IPSASB regarding the Boards' respective Conceptual Framework projects, in the context of the Memorandum of Understanding between the IASB and the International Federation of Accountants dated 22 November 2011. If the Conceptual Framework is true to its objective of improving resource allocation decisions, it is the consistency of the two Boards' attempts to be faithful to the economics that will help bring them together.
- 30 These comments in paragraphs 27 – 29 above are elaborated on in Appendix D of this submission.
- 31 The AASB's other significant (although less serious) concerns with the DP are set out in Appendix B. As an aid to IFRS Foundation staff in classifying the views in this submission, the AASB's responses to the specific matters for comment in the DP will be set out in a supplementary paper that will be sent shortly.
- 32 The AASB encourages the IASB to develop a non-technical communications document regarding the objective and broad content of general purpose financial reporting, to complement the revised IASB Conceptual Framework and help broaden the range of constituents who understand those matters. Such a document, targeted at interested parties (such as some members of senior management) not well versed in accounting standards, could usefully clarify that general purpose financial reporting is not intended to include all financial information about an entity and, in that context, could delineate more clearly the boundaries of general purpose financial reporting.

33 If you have any queries regarding matters in this submission, please contact me or Jim Paul (jpaul@aab.gov.au).

Yours sincerely

Kevin Stevenson
Chairman and CEO

APPENDIX A

Elaboration of the AASB's most serious concerns

Serious concerns of a general nature

Standards-level rules / current conventions, rather than concepts

- A1 As mentioned in paragraph 6(a) above, the AASB considers that the preliminary views addressing gaps in the Conceptual Framework are seriously inadequate. In some cases, this is because the preliminary views are more in the nature of standards-level rules or a catalogue of current conventions than concepts. For example, the sections of the DP on measurement, and presentation and disclosure, exhibit those characteristics. The AASB's serious concerns with these sections of the DP are discussed below in paragraphs A18 – A38 and A39 – A43, respectively. Other examples of preliminary views giving rise to this concern are:
- (a) the preliminary view in paragraph 5.57 of the DP that “the revised *Conceptual Framework* should indicate that an entity should treat some obligations that oblige the issuer to deliver economic resources as if they were equity instruments ... Arguably, this treatment might be appropriate if the obligations are the most subordinated (lowest ranking) class of instruments issued by an entity (such as some co-operatives or mutuals) that would otherwise report no equity.” This preliminary view does not address the fundamental issue of whether, in concept, it would be representationally faithful for some entities to report no equity; and
 - (b) paragraph 5.21 of the DP seems to presume that separate presentation of non-controlling interests (NCI) in an entity's equity, as required by IAS 1 *Presentation of Financial Statements*, should be endorsed in the revised IASB Conceptual Framework, without discussing the fundamental issue of whether, in concept, such separate presentation is appropriate (see paragraphs B82 – B86 of Appendix B below).
- A2 A robust Conceptual Framework should focus on ideal principles focused on economic phenomena, regardless of the practicality or acceptability of treatments. As paragraph OB11 of the IASB Conceptual Framework says:
- “The concepts are the goal towards which the Board and preparers of financial reports strive. As with most goals, the *Conceptual Framework's vision of ideal financial reporting* is unlikely to be achieved in full, at least not in the short term ... Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve its usefulness.” (underlining added for emphasis)
- A3 In developing ideal principles, a standard setter generally should not “peek ahead” to whether applying those principles would result in acceptable (popular) treatments of particular transactions, other events or circumstances. The purpose of the

Conceptual Framework should not be to justify treatments in existing standards or practices. Otherwise, the IASB's thinking could be closed to new ideas. In a Conceptual Framework, the concepts should drive the analysis of individual issues, rather than the reverse applying.

- A4 However, in some places in the DP, the analysis of individual issues seems to drive the development of the proposed concepts. For example, the DP's discussion of other comprehensive income (OCI) and recycling seems focused on broadly justifying (albeit refining) the approach presently reflected in IFRSs. Including the preliminary views on this issue would seem to rationalise in the Conceptual Framework a standards-level treatment that lacks a logical conceptual basis for faithfully representing economic phenomena affecting the entity. Providing a purported conceptual rationale for an existing treatment or requirement that does not faithfully represent economic phenomena would be a serious concern in the Conceptual Framework, because it would elevate pragmatic accounting responses to issues to the level of concepts, and thus would be likely to mis-educate readers of the Conceptual Framework.
- A5 Consistent with the discussion in paragraph OB11 of the IASB Conceptual Framework, identifying a concept does not imply it should necessarily become a requirement of an IFRS. There might be good reasons not to require a particular concept to be applied at a standards level, such as cost/benefit considerations and the availability of information necessary to enable the concept to be applied (e.g. the revaluation of inventories to a current market price exceeding cost might not be required for inventories that turn over within a short period, for cost/benefit reasons). Standard setters should not be too uncomfortable with developing particular requirements in standards that differ from their Conceptual Framework; but, ideally, this outcome should be the exception rather than the rule, and the reasons for the departure should be adequately explained. The AASB considers that there is no harm in signalling the direction in which financial reporting requirements should ultimately evolve while acknowledging that, for cost/benefit or other reasons, various of those requirements will not change at present¹². Identifying a conceptually ideal treatment would make the IASB's decision making more transparent, because the IASB would need to explain its reasons for the decisions it makes in developing or amending individual IFRSs. This would enhance the IASB's accountability.
- A6 Indeed, the IASB has acknowledged in places in the DP that particular requirements in standards might differ from its Conceptual Framework—for example:
- (a) the DP notes that all assets and liabilities should ideally be recognised (paragraph 4.24) but doing so might not provide relevant information if identifying the resource or obligation is unusually difficult—e.g. some internally generated intangible assets—or measuring the resource or

¹² Note also the AASB's suggestion, in paragraphs B10 – B17 of Appendix B below, that the IASB Conceptual Framework should explicitly distinguish concepts that should presently be considered when applying paragraph 11(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* from concepts that signal a pathway to future best practice.

obligation requires unusually difficult or exceptionally subjective allocations of cash flows [paragraphs 4.26(c) and 4.26(d)];

- (b) the DP says measuring some assets and liabilities at current market prices would provide more relevant information than (historical) cost-based measurements, but “estimating current market prices when they cannot be obtained directly can be costly and subjective” (paragraph 6.13); and
- (c) if ‘Approach 2A’ to reporting OCI were considered conceptually ideal, one way of dealing with the remeasurement of net defined benefit assets and liabilities would be to “accept that remeasurements of a net defined benefit pension asset or liability do not fit the concept of a bridging item or mismatched remeasurement, but require the use of OCI regardless ... when developing or revising particular Standards” (paragraph 8.74)¹³.

However, the IASB seems reluctant to follow this through and identify concepts (such as concepts for derecognition of components of assets and liabilities, and an ideal concept of wealth) that might nevertheless be modified in IFRSs.

‘Deferral’/relegation of conceptual issues to standards-level projects

A7 Another reason why the AASB considers that some preliminary views addressing gaps in the Conceptual Framework are seriously inadequate is that they indicate various pervasive issues should be addressed only at a standards level without conceptual underpinnings to guide those standards-level decisions, even though resolving a number of them would seem likely to require an overarching principle. The AASB thinks the Conceptual Framework is the place to establish appropriate overarching principles. Establishing such overarching principles in the Conceptual Framework should minimise the risk that decisions will be ad hoc and inconsistent, and should enhance the IASB’s communication with its constituents, because its thinking will be more explicit. This does not preclude also addressing those issues at a standards level; at least some of them would also warrant being dealt with in more detail at a standards level. For example, the ‘unit of account’ issue noted in paragraph A8(f) below would need standards-level guidance, but that guidance should be developed from concepts.

A8 Examples of the types of issues referred to in paragraph A7 above are:

- (a) how to deal with **uncertainty about whether an asset or a liability exists** [paragraph 2.35(b) of the DP says: “in rare cases it is uncertain whether an asset or a liability exists. The Conceptual Framework should not set a probability threshold to determine whether an asset or a liability exists in those rare cases. If there is significant uncertainty about whether an asset or a liability exists, the IASB would decide when developing or revising an IFRS how to deal with that uncertainty.”];

¹³ It should be borne in mind that the AASB strongly disagrees in principle with any approach to reporting OCI that involves recycling (such as ‘Approach 2A’): see paragraphs A68 – A74 below.

- (b) the concept for **derecognition** if an entity retains a component of an asset or a liability [although paragraph 4.50 of the DP sets out a general preliminary view on derecognition that an entity should derecognise an asset or a liability when it no longer meets the recognition criteria, that paragraph also says that, if an entity retains a component of an asset or a liability, the IASB should determine in Standards projects whether to apply that general preliminary view];
- (c) how to **measure equity claims**, if the Conceptual Framework were (consistently with paragraph 5.13(c) of the DP) to conclude that, in concept, an entity should, at the end of each period, update the measurement of each class of equity claim¹⁴ [paragraph 5.18 of the DP says: “If the IASB decided to introduce a requirement to measure equity claims, it would need to determine when it develops or revised particular Standards what measure to use for particular classes of equity claim For example, the IASB might decide: (a) to use an allocation of the underlying net assets as the measurement of primary equity claims. . . (b) to measure secondary equity claims in the same manner as an entity would measure a comparable financial liability . . .”];
- (d) whether, for ‘an entity that has issued no equity instruments’ (e.g. the entity has issued puttable financial instruments that give the holders a pro rata residual interest in the entity’s net assets and oblige the entity to deliver cash or other assets to the holders on liquidation, or on early redemption at an amount broadly equivalent to that pro rata share), it is appropriate to **treat the most subordinated class of instruments as if it were an equity claim** [although paragraph 5.57 of the DP says “the revised *Conceptual Framework* should indicate that an entity should treat some obligations that oblige the issuer to deliver economic resources as if they were equity instruments”, Question 10(d) says “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.” It is unclear to the AASB whether the latter statement is merely a reminder that changes in requirements occur through standards-level projects, or whether the IASB intends to address this issue only at a standards level.];
- (e) the **business model concept** [paragraph 9.32 says the DP does not define the business model concept, but “the IASB’s preliminary view is that financial statements can be made more relevant if the IASB considers, *when it develops or revises particular Standards*, how an entity conducts its business activities” (emphasis added)];
- (f) the **unit of account** [paragraph 9.38 of the DP says “The IASB’s preliminary view is that deciding which unit of account will provide the most useful information to existing and potential investors, lenders and other creditors will normally be a decision for projects to develop or revise

¹⁴ Note that the AASB would disagree with such a conceptual conclusion: see paragraphs B59 – B69 of Appendix B below.

particular Standards, rather than a decision that can be resolved conceptually for a broad range of Standards.”]; and

- (g) **concepts of capital maintenance** [paragraph 9.49 of the DP says: “... the IASB believes that the issues associated with capital maintenance are best dealt with at the same time as a possible project on accounting for high inflation rather than as part of the *Conceptual Framework* project. ...”]. As discussed in paragraphs A27 – A32 above (regarding the over-arching topic of an ideal concept of wealth (‘capital’)) and paragraphs B142 – B148 of Appendix B below [regarding an ideal concept of economic income (‘capital maintenance’)], the AASB strongly disagrees with treating the issues associated with capital maintenance as being relevant only for hyper-inflationary economies and deferring consideration of these concepts, such as by addressing them in subsequent standards-level projects.

- A9 Within the context of its comments in paragraphs 9 and 27 above, the AASB acknowledges that some of these issues might not be able to be resolved satisfactorily in concept for some time (e.g. unit of account). If so, the AASB would prefer the IASB at least signposts that it will revisit and update the Conceptual Framework within a reasonable timeframe, rather than treating those issues as solely standards-level issues.

Backward steps: incorporating accounting responses that do not represent economic phenomena

- A10 As mentioned in paragraph 6(b) above, the AASB considers that particular preliminary views (see below) represent a significant backward step from the existing Conceptual Framework. This is because the existing Conceptual Framework only identifies economic phenomena as elements of financial statements, whilst some preliminary views would involve an entity recognising in its financial statements things (accounting responses) that are not economic phenomena, at least not in the period in which they are recognised. Those preliminary views are that:
- (a) an entity should recognise some items of income and expense in OCI and subsequently recycle them to profit or loss – this would involve recognising particular economic phenomena (inflows and outflows of economic resources) twice in one component or another of comprehensive income. Recycling those items would report as income and expenses in profit or loss items that are not inflows or outflows of economic resources in the period in which they are recycled (because they occurred when they were previously recognised). Weakening the Conceptual Framework’s commitment to recognising only economic phenomena affecting an entity would be a fundamental concern;
- (b) ‘directly’ remeasuring changes in some classes of equity at the end of each period – this would conflict with the general principle that an entity’s financial statements depict economic phenomena affecting the entity, and not economic phenomena affecting other parties only. No changes in the

entity's assets or liabilities, or future cash flows, occur as a result of changes in the value of its equity instruments to equity holders (see paragraphs B59 – B69 of Appendix B below); and

- (c) a possible approach when an entity retains a component of an asset or a liability is continuing to recognise the original asset or liability, and treating the proceeds received or paid for the transfer as a loan received or granted, even though the original asset or liability has not been fully retained (paragraph 4.50(c) of the DP) (see paragraphs B50 – B52 of Appendix B below).
- A11 The AASB strongly encourages the IASB to confirm the approach in the existing IASB Conceptual Framework that only economic phenomena are to be reported in financial statements, which would be a pre-requisite for ensuring the Conceptual Framework remains principle-based and meets the fundamental qualitative characteristics of relevance and faithful representation.
- A12 It should be borne in mind that economic phenomena are not always recognised as elements of financial statements. For example, it might be inappropriate to recognise some assets or liabilities because, consistent with the preliminary view in paragraph 4.25(b) of the DP, no measure of the asset or liability would result in a faithful representation of that asset or liability, even if all necessary descriptions and explanations are disclosed.
- A13 Conversely, some items that are not economic phenomena are currently recognised as elements of financial statements because, for example, an accounting standard departs from concepts that are grounded in economic phenomena. An example of this would be where, in accordance with paragraphs 12 and 17 of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, an entity recognises 'deferred income' in the statement of financial position in respect of a government grant that is intended to compensate for future expenses but does not meet the definition of a liability.
- A14 In relation to paragraph A12 above, it is important to separately identify the economic phenomena affecting an entity before considering which of those economic phenomena might merit recognition. If, instead, the IASB Conceptual Framework were to focus only on elements of financial statements that are likely to be recognised, or currently are recognised under accounting standards, important economic phenomena might be overlooked. Such an outcome would preclude the possibility that changes in the way financial information is obtained, recorded and displayed might overcome present difficulties in faithfully representing those elements at a cost that does not exceed the benefits to users of financial reports.

Preliminary views include exceptions to the draft concepts

- A15 For various issues, the preliminary views are that exceptions should be made from the draft concepts. This strongly suggests the concepts for those issues are insufficiently robust or inappropriately interpreted in relation to particular transactions, events or circumstances. Examples are given in

paragraphs A16 – A17 below, separated into those in respect of which the AASB broadly agrees, or disagrees, with the draft concept.

AASB broadly agrees with the draft concept

A16 Examples of preliminary views (with which the AASB broadly agrees), and the exceptions the DP contemplates providing to them (with which the AASB disagrees), are:

- (a) the DP includes a draft concept (preliminary view) that the aim of accounting requirements for a transaction that may result in derecognition should include representing faithfully the resources and obligations remaining after the transaction (paragraph 4.34 of the DP). However, contrary to that draft concept, the DP expresses a preliminary view that a possible approach when an entity retains a component of an asset or a liability is continuing to recognise the original asset or liability, and treating the proceeds received or paid for the transfer as a loan received or granted (paragraph 4.50(c) of the DP); and
- (b) the DP includes a draft concept (preliminary view) that the Conceptual Framework should use the definition of a liability to distinguish liabilities from equity instruments, using the ‘strict obligation approach’ (paragraphs 5.34(a) & (b), and 5.37(a) & (b) of the DP). However, contrary to that draft concept, the DP expresses a preliminary view that 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, e.g. the DP says this might be appropriate for particular puttable instruments giving holders a residual interest in the entity’s net assets (paragraphs 5.55 – 5.57 of the DP).

AASB disagrees with the draft concept

A17 Examples of preliminary views (with which the AASB disagrees), and the exceptions the DP contemplates providing to them (which demonstrate the lack of robustness of the draft concept), are:

- (a) the DP includes a draft concept (preliminary view) that an entity should update the measure of each class of equity claim at the end of each reporting period. However, contrary to that draft concept, the DP expresses a preliminary view that a fundamentally different approach for primary and secondary equity claims might be used [i.e. primary equity claims, such as issued shares and retained earnings, might continue to be measured by allocating the recognised amounts of the underlying assets and liabilities; whilst secondary equity claims, such as options written over the entity’s shares, might be measured ‘directly’ by reference to the market price of those instruments (which is independent of the recognised amounts of assets and liabilities)] (paragraphs 5.15 and 5.18 of the DP). The AASB’s reasons for disagreeing with directly remeasuring any equity claims (instead, the AASB would support measuring all equity claims by allocating the

recognised amounts of the underlying assets and liabilities) are discussed in paragraphs B59 – B69 of Appendix B below;

- (b) the DP includes a draft concept (preliminary view) that the measurement of a particular asset should differ according to whether that asset is expected to contribute directly or indirectly to the generation of future cash flows (paragraphs 6.16, 6.78 – 6.80 and 6.83 of the DP). However, contrary to that draft concept, the DP expresses a preliminary view that the measurement of financial assets held for collection should significantly depend on the degree of variability of the contractual cash flows (paragraphs 6.19 and 6.89(a) and of the DP). For the reasons discussed in paragraphs B90 – B125 of Appendix B below, the AASB strongly disagrees with the above-mentioned draft concept. It also considers that the proposed exception to that draft concept indicates a lack of robustness of that draft concept (see paragraph B92 of Appendix B below); and
- (c) the DP includes a draft concept (preliminary view) that presenting in OCI items of income and expense resulting from (historical) cost-based measurements would be inappropriate (paragraph 8.47 of the DP). However, the DP contradicts that draft concept by describing ‘cost-based measurements’ as including the following current value measures:
 - (i) impairments of assets; and
 - (ii) increases to the carrying amounts of liabilities that have become onerous (paragraph 8.51 of the DP).

For the reasons discussed in paragraphs A54 – A57 below, the AASB disagrees with basing any distinction between profit or loss and OCI particularly on whether the items of income and expense result from (historical) cost-based measurements (instead, as mentioned in paragraph 25 above, the AASB would support the development of principles for a multi-faceted disaggregation of comprehensive income, classifying items of economic income according to their different implications for predicting the amount, timing, uncertainty and velocity of future cash flows¹⁵).

In explaining the preliminary view that recognising some items of income and expense in OCI would enhance the relevance of profit or loss, paragraph 8.48 of the DP says “some changes in the current measures of assets and liabilities may not have the same predictive value as cost-based information about transactions, consumption and impairment of assets, and fulfilment of liabilities”. However, whilst the remeasured carrying amounts of impaired assets and onerous liabilities are clearly relevant to an entity’s users, it is not apparent why remeasurements of those assets and liabilities have a different predictive value than other

¹⁵ These differentiated implications for predicting future cash flows would not depend simply on whether the items of income and expense result from (historical) cost-based measurements. In addition, in concept, the AASB would not support (historical) cost-based measurements of assets and liabilities.

remeasurements (i.e. why does volatility matter in some cases but not others?). The distinctions referred to in paragraphs (c)(i) and (ii) immediately above appear to be exceptions from the approach to distinguishing OCI from profit or loss.

Serious concerns regarding specific sections of the DP

Section 6—Measurement

General comments on Section 6

- A18 The AASB strongly disagrees with the preliminary view in paragraph 6.35(b) of the DP that a single ideal measurement model should not be identified in the IASB Conceptual Framework (see paragraphs A22 – A38 below for specific comments on that preliminary view). The AASB observes that the mixed-measurement requirements in IFRSs presently lack coherence. For example:
- (a) different assets are measured variously at historical cost (for example, some items of property, plant and equipment), fair value (some investment properties), fair value plus directly attributable transaction costs (some financial assets), fair value less costs to sell (biological assets), and value in use (some impaired assets); and
 - (b) different liabilities are measured variously at the amounts paid by customers for promised goods and services (liabilities to customers in revenue arrangements), i.e. the ‘customer consideration amounts’ of those liabilities, and the estimated cost to the entity of providing promised cash, goods or services (employee benefits and provisions). This difference in treatment arguably is not conceptually consistent in relation to items, such as warranty obligations, that have a customer consideration amount and are by nature employee benefits or provisions.
- A19 The measurement bases described in paragraphs A18(a) and A18(b) above differ in respect of whether:
- (a) historical or current prices are used; and
 - (b) estimated cash flows reflected in the measurement are those of the entity or those of other market participants.
- A20 These examples in paragraphs A18 – A19 above illustrate the pressing need for a single conceptual measurement model to provide a foundation for developing consistent measurement requirements. Paragraphs B126 – B141 of Appendix B below discuss the conceptual measurement model the AASB considers to be ideal (whilst acknowledging that no measurement model is without drawbacks).
- A21 Consistent with the comments in paragraph A5 above, identifying a single conceptually ideal measurement model would not remove the IASB’s discretion to develop or retain requirements that differ from that model in individual IFRSs. In

this regard, Appendix C below illustrates how the measurement model the AASB considers to be conceptually ideal might be modified at a standards level for application in a manner that:

- (a) is not radically different from extant IFRSs; and
- (b) would enhance the consistency and coherence of measurement bases applied and consequently enhance the relevance, comparability and understandability of measures recognised.

Specific comments on Section 6

A22 In the context of recognition of the elements of the financial statements that entities currently prepare¹⁶, the AASB strongly disagrees with the IASB’s preliminary view that a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements. The AASB considers that, in concept, current values of assets and liabilities would always be more useful than historical cost-based measurements for predicting the entity’s future cash flows and thus helping to meet the ‘resource allocation decision’ objective of financial reporting (see also paragraphs A34 – A37 below).

A23 The AASB notes that the reasons given in paragraph 6.13(b) of the DP for not measuring all assets and liabilities at current values (“a current market price”) are either:

- (a) that some users consider (historical) ‘cost-based information’ more relevant; or
- (b) the cost and subjectivity of estimating market prices are too great.

A24 The way the reason noted in paragraph A23(a) above is presented in the DP implies to the AASB that the IASB considers it should enunciate a single measurement basis (or model¹⁷) only if all—or an overwhelming majority of—the users of financial statements consider that a particular measurement basis would provide the most relevant information to them. However, the AASB considers that, rather than treating the support of users as a pre-requisite for a conceptually ideal measurement

¹⁶ The AASB considers that, to meet the different common information needs of users, it might be appropriate to report current value measures of assets and liabilities that differ from those recognised in the financial statements. Such different current value measures might be reported in notes and/or additional financial statements to those currently prepared. For example, if assets and liabilities were measured at current market entry prices in the statement of financial position, information about the current market exit prices of those assets and liabilities might be considered relevant for disclosure in notes or an additional financial statement prepared to provide information about the entity’s capacity to change its business model(s) and its capacity to finance alternative business model(s).

¹⁷ Some measurement models that can be applied to all assets (for example: the lower of historical cost and recoverable amount; and deprival value) encompass more than one measurement basis. The AASB considers the key issue is identifying an ideal concept of ‘wealth’ and the resulting measurement model that should, in concept, be applied (regardless of whether that model encompasses more than one measurement basis). Therefore, this submission refers mainly to whether a single measurement *model* would be conceptually ideal, albeit that a model (for example, current cash equivalents commanded, i.e. exit value) might be comprised of a single basis.

basis or model, the IASB has a responsibility to select a conceptually ideal measurement basis or model, based on its view of what would provide the most useful information to users, albeit having consulted on the issue at a conceptual level.

- A25 The AASB considers that the reason noted in paragraph 23(b) above is a standards-level concern that is therefore irrelevant to identifying concepts. It is important that the Conceptual Framework identifies principles that should be applied in the absence of impediments to implementation, so that the goal of an issue's treatment is identified and any modifications of the ideal treatment warranted for practical reasons have a clear reason and a common starting point. Otherwise, standards-level decisions would tend to be based on 'micro logic' developed in the context of particular transactions within the specific scope of each standard, with the risk of ad hoc and inconsistent decisions in different standards.
- A26 In contrast to the approach advocated by the AASB in paragraph A25 above, the DP sometimes takes practical application issues into account without first identifying overarching measurement principles. For example, paragraph 6.13(b) of the DP observes that: "... estimating current market prices when they cannot be obtained directly can be costly and subjective. Consequently, measuring all assets and liabilities at a current market price may not provide users of financial statements with sufficient benefits to justify the costs of determining (or estimating) those prices."

Important qualities of measurement concepts

- A27 As mentioned in paragraphs 12 and 13 above, the AASB considers that, in addition to specifying the measurement objective in paragraph 6.35(a) of the DP, the Conceptual Framework should:
- (a) specify a key objective of identifying measurement bases or attributes that provide the most useful information for predicting the entity's future cash flows; and
 - (b) include measurement concepts that (if applied) would result in measurements possessing the following qualities:
 - (i) the amounts can meaningfully be added, subtracted and compared; and
 - (ii) their economic significance, individually and collectively, is capable of being understood.
- A28 Thus, in relation to paragraph A27(b) above, the AASB agrees with the comments in paragraph 6.12 of the DP, and finds them more persuasive than the contrary arguments in paragraph 6.13(b) discussed in paragraphs A23 – A25 above.
- A29 As mentioned in paragraph 14 above, to achieve the goals in paragraph A27(b) above, the measurements must have a common property. This, in turn, would require identifying an ideal concept of 'wealth' (i.e. the capability to contribute to

generating cash flows to the entity), having regard to the common information needs of users, rather than presuming a mixed measurement model¹⁸ in concept. In other words, a clear articulation of the meaning of ‘economic benefits’ in the definition of an asset or a liability would be necessary. Without that articulation, users cannot be expected to obtain a common understanding of the economic significance of an entity’s reported assets and liabilities in assessing the entity’s capability to interact with its economic environment in pursuing its objectives. The concepts of wealth most commonly identified and debated in the academic accounting literature are ‘invested money capital’, ‘operating capability’ and ‘current cash equivalents commanded’ (see paragraph 15 above for brief descriptions of these concepts).

- A30 Identifying an ideal concept of wealth would also enable the economic significance of the entity’s reported economic income (i.e. change in wealth from all recognised transactions and other events of the period, other than transactions with owners acting in their capacity as owners) to be understood¹⁹. Any sub-division of economic income to aid analysis of its components would not obscure its meaning, because the total of economic income would be clear (in contrast to the present lack of clarity under IFRSs—which would not seem to be clarified by the preliminary views in the DP—regarding whether an entity’s economic income is its profit or loss, or also includes some or all items of OCI). Under an identified concept of wealth, profit or loss and OCI might be distinguished as separate categories of economic income, but each such item would be recognised only once in economic income; that is, profit or loss and OCI would be additive, and there would be no recycling of OCI into profit or loss (see also the comments in paragraph A10(a) above).
- A31 Related to the comments in paragraph A30 above, an example of a key issue dependent on the concept of wealth is the treatment of revaluations (or other remeasurements) of assets and liabilities. The treatment of such remeasurements (i.e. whether the remeasurements are recognised within economic income for the period) reflects a view, implicitly or explicitly, of the nature of an entity’s wealth. This is on the basis that an entity’s economic income represents the change in the entity’s wealth for the period, excluding ownership contributions and ownership distributions. Some argue that revaluation increases and decreases recognised in accordance with IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* should be excluded from comprehensive income (i.e. adjusted directly against equity, through the statement of changes in equity). Some of them argue this because they consider that an entity’s wealth is its operating capability, and therefore that revaluation increases for those assets should be treated as repricing

¹⁸ In this context, a mixed measurement model encompasses multiple concepts of wealth. In contrast, a measurement model based on a single concept of wealth, such as invested money capital or operating capability, might involve more than one measurement basis (see also the footnote to paragraph A24 above).

¹⁹ This is acknowledged in the existing IASB Conceptual Framework, although it is not focused on in the DP. Paragraph 4.24 of the existing Framework says: “The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the entity in preparing its financial statements.”

the same operating capability (or service potential)²⁰, instead of representing inflows or enhancements of the wealth those assets embody (see also paragraph B144 in Appendix B below). Treating the classification of changes in the values of assets and liabilities as a presentation issue (that is, a choice between profit or loss and OCI)—as occurs under ‘Approach 2B: broad approach to OCI’ discussed in paragraphs 8.79 – 8.94 of the DP—does not address the fundamental issue of whether the entity’s wealth has changed as a result of those events. Identifying an ideal concept of wealth enables an entity’s economic income for the period to be robustly defined.

- A32 Omitting to explicitly address concepts of wealth in the Conceptual Framework would not make the issue go away. Each measurement attribute selected implicitly represents a particular concept of wealth. Thus, the choice is between implicit and potentially conflicting concepts of wealth, and an explicit coherent concept of wealth.
- A33 As mentioned in paragraph 19 above, a consequence of identifying an ideal concept of wealth would be that the ideal measurement basis for a particular asset would not differ according to whether the asset is expected to contribute *directly* or *indirectly* to the generation of future cash flows (even though an ideal concept of wealth should identify measurement bases or attributes that provide the most useful information for predicting the entity’s future cash flows). Therefore, the AASB strongly disagrees with the preliminary views in paragraphs 6.16, 6.78 – 6.80 and 6.83 of the DP, which identify different measurement bases for particular assets according to whether those assets contribute *directly* or *indirectly* to the generation of future cash flows (see paragraphs B86 – B121 below for an elaboration). In addition, the AASB notes that the DP includes numerous assertions that, depending on the likely assessments of investors, creditors and other lenders regarding whether the same type of asset or liability will contribute directly or indirectly to future cash flows, those users will find one measurement basis more relevant than others (see, for example, paragraphs 6.13(b), 6.16(a), 6.16(b), 6.79, 6.88, 6.94 – 6.95, 6.103 and 6.108 of the DP). It is unclear to the AASB how the IASB came to those conclusions about which measurement bases are more relevant in particular circumstances (i.e. what evidence did it draw upon?)²¹.
- A34 In arguing that current values of assets and liabilities would always be more useful than (historical) ‘cost-based measurements’ for meeting the ‘resource allocation decision’ objective of financial reporting:

²⁰ Similarly, paragraph 8.76 of the DP says “Some are of the view that revaluations in accordance with IAS 16 and IAS 38 were originally intended to be physical capital maintenance adjustments ...”. However, the AASB does not regard operating capability to be a physical concept of wealth, or capital. This is because it is measured in financial terms (not physical units of output capacity). Specifically, an entity’s operating capability is the entity’s ability, at any given time, to carry out its activities at the scale determined by its then-existing resources, *both monetary and non-monetary* (but measured in financial terms). The fact that this is a financial measure is evidenced by the inclusion of a recoverable amount test in the determination of operating capability, consistent with that in IAS 36 *Impairment of Assets*.

²¹ See paragraphs A36 – A37 below regarding the findings of some academic studies into the ‘value relevance’ of reported current values to users’ resource allocation decisions.

- (a) as a matter of logic, the AASB considers that, in considering the various alternative measurement bases, the IASB should assume there are material differences between their amounts. The analysis should not be clouded by confusing amounts that may, in practice, happen to be similar (e.g. the measured amounts for items turning over quickly and for which historical and current values may not be far apart). After all, if amounts are similar, no choice is needed; the choice matters in concept when amounts differ significantly;
- (b) the AASB cannot conceive of a resource allocation decision or accountability assessment that logically would be based on historical prices (which represent sunk costs) of assets and of the consumption of those assets in preference to being based on current values of assets and of the consumption of those assets (which reflect the current environment and operations of the reporting entity). This view of the AASB is supported by various findings in evidence-based academic research that current values provide more relevant information than historical costs for predicting an entity's future cash flows and are reflected in the pricing of entities' equity securities (see paragraph A36 below); and
- (c) the AASB is not suggesting that IFRSs should require all assets and liabilities to be measured at current values. Identifying a concept does not imply it should necessarily become a requirement of an IFRS. There might be good reasons not to require a particular concept to be applied at a standards level, such as cost/benefit considerations and the availability of information necessary to enable the concept to be applied. As commented on in paragraph A5 above, the IASB should not be too uncomfortable with developing particular requirements in standards that differ from its Conceptual Framework, although ideally this outcome should be the exception rather than the rule and the reasons for the departure should be adequately explained.

A35 An illustration of the AASB's view in paragraph A34(b) above is two facilities with identical capacities, outputs and revenues, where one facility is considerably newer than the other and its depreciation expense (based on a much greater cost of acquisition) is accordingly much greater. The different reported profitability of the two facilities solely reflects the facilities' different acquisition dates. The AASB is unaware of any resource allocation decisions or accountability assessments²² of users of financial reports that would logically be based on the historical cost-based reported performance of the facilities in preference to those facilities' current value-based reported performance. As mentioned in paragraphs 17 – 18 above, current market entry prices possess information value for predicting future cash flows to the entity that is not shared by historical costs.

A36 As mentioned in paragraph A34(b) above, various academic studies have found that current values provide more relevant information than historical costs for predicting

²² 'Accountability assessments' are referred to here with the same meaning they have (implicitly) in paragraphs OB4 and OB16 of the IASB Conceptual Framework (revised 2010).

an entity's future cash flows, and are reflected in the pricing of entities' equity securities. Examples of these findings are:

- (a) in a study from 1971 – 1990 of banks (primarily U.S. banks) for banks whose financial statement data are on the 1990 Compustat Annual Bank Tape, Barth²³ found that disclosure of fair value estimates of those banks' investment securities provide significant additional explanatory power of those banks' share prices (in comparison with disclosure of those securities' historical costs);
- (b) in another study from 1971 – 1990 of U.S. banks whose financial statement data are on the 1990 Compustat Annual Bank Tape²⁴, Barth, Landsman and Wahlen²⁵ found that “Changes in interest rates that result in changes in fair values of investment securities are reflected in bank share prices. Investors apply earnings multiples to banks' interest revenue that vary inversely with interest rate changes, even though contractual cash flows of investment securities are unaffected by changes in interest rates.”;
- (c) in a study of 72 Australian industrial firms from 1981 – 1990, Easton, Eddey and Harris²⁶ found that aggregate revaluation reserve increments in respect of tangible long-lived assets have significant explanatory power for returns over earnings and changes in earnings;
- (d) in a study of data for 1,334 upward current year revaluations of fixed assets by UK firms from 1983 – 1995, Aboody, Barth and Kasznik²⁷:
 - (i) estimated the relation between those revaluations and changes in operating performance over the subsequent one to three years, and found consistent evidence that current year revaluations are positively associated with changes in operating performance over all three time horizons; and
 - (ii) found that cumulative revaluation increments are significantly positively related to share prices; and
- (e) in a study of financial statements of 350 Australian firms with publicly traded equity securities (including the largest 100 firms) from 1991 – 1995, analysed separately for financial, mining and non-financial industry

²³ Barth, M. E. “Fair Value Accounting: Evidence from Investment Securities and the Market Valuation of Banks”, *The Accounting Review*, Vol. 69, No. 1, January 1994, pp. 1 – 25.

²⁴ The study indicated that the largest sample in any year was 137 banks in 1989.

²⁵ Barth, M. E.; W. R. Landsman and J. M. Wahlen, “Fair value accounting: Effects on banks' earnings volatility, regulatory capital, and value of contractual cash flows”, *Journal of Banking & Finance* 19, 1995, pp. 577 – 605.

²⁶ Easton, P. D.; P. H. Eddey and T. S. Harris, “An Investigation of Revaluations of Tangible Long-Lived Assets”, *Journal of Accounting Research* (Supplement 1993), pp. 1 – 38.

²⁷ Aboody, D.; M. E. Barth and R. Kasznik, “Revaluations of fixed assets and future firm performance: Evidence from the UK”, *Journal of Accounting & Economics* 26, 1999, pp. 149 – 178.

classifications, Barth and Clinch²⁸ found that revalued investments²⁹, intangible assets and property, plant and equipment³⁰ are consistently significantly associated with share prices.

- A37 In relation to the studies referred to in paragraphs A36(c) – (e) above, it should be noted that the examined revaluations of property, plant and equipment would generally have been determined on a current market entry price basis.
- A38 The AASB’s other key concerns regarding the DP’s discussion of Measurement, and further background on the AASB’s concerns in paragraphs A22 – A37 above, are set out in paragraphs B87 – B141 below.

[Paragraphs A39 – A43 omitted from this extract]

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

- A44 The AASB strongly disagrees with the preliminary views that:
- (a) comprehensive income should necessarily be bifurcated into profit or loss and OCI [paragraph 8.22 of the DP], and that profit or loss (stripped of items presented in OCI) should be treated as providing the primary source of information about an entity’s return on its economic resources [paragraphs 8.40(a), 8.46 and 8.81(a) of the DP]; and
 - (b) the Conceptual Framework should permit or require at least some items of income and expense previously recognised in OCI to subsequently be recycled in profit or loss [paragraph 8.26 of the DP].

In particular, the AASB fundamentally disagrees with the preliminary view referred to in (b) immediately above. These concerns of the AASB in (a) and (b) immediately above are elaborated on in paragraphs A47 – A74 below.

- A45 Section 8 of the DP characterises the issue of whether to distinguish profit or loss and OCI as being inextricably linked to the issue of whether recycling at least some items of income and expense previously recognised in OCI should be either permitted or required. Paragraph 8.23 of the DP says:

“In discussing whether the *Conceptual Framework* should include a concept for profit or loss, the arguments for and against recycling also need to be considered. This is because, if there is no recycling, then profit or loss is no different in nature from other totals or subtotals.”

- A46 However, the AASB is commenting separately on these two issues referred to in paragraphs A44(a) and A44(b) above. This is because, even without recycling, or

²⁸ Barth, M. E.; and G. Clinch, “Revalued Financial, Tangible, and Intangible Assets: Associations with Share Prices and Non-Market-Based Value Estimates”, *Journal of Accounting Research*, Vol. 36 (Supplement 1998), pp. 199 – 233.

²⁹ Except for investments of non-financial firms in associated companies.

³⁰ In aggregate, but not for each of the industry classifications.

with recycling of some but not all items of OCI (as ‘Approach 2B to OCI’ would permit), the issues arise of:

- (a) whether comprehensive income should necessarily be bifurcated into profit or loss and OCI; and
- (b) if so, the basis on which profit or loss and OCI should be distinguished.

Distinction between profit or loss and OCI

Overview

A47 The AASB’s key reasons for strongly disagreeing with the preliminary views noted in paragraph A44(a) above are that:

- (a) it considers that it would be conceptually inappropriate to classify continuous variables as if they were discrete. That is, binary classification of economic (‘comprehensive’) income should not be adopted, given the range of ways in which economic income could (and should) be classified with differentiated implications for predicting the entity’s future cash flows (see paragraphs A48 – A49 below);
- (b) the notion of OCI is not part of an integrated theory of presentation of financial performance. Any concepts for particular categorisation of economic income should be developed as part of an integrated theory (see paragraph A50 below); and
- (c) it considers that the DP does not establish a coherent principle for determining when it is more relevant to present an item in OCI rather than in profit or loss. Furthermore, it seems unlikely that such a principle could be developed, given [as referred to in (a) immediately above] the range of ways in which economic income could (and should) be classified with differentiated implications for predicting the entity’s future cash flows (see paragraphs A51 – A61 below).

Binary classification of income and expenses

A48 As mentioned in paragraph A47(a) above, the AASB considers that it would be conceptually inappropriate to classify continuous variables as if they were discrete. Therefore, rather than conceptually specifying a binary classification of economic income, principles for a multi-faceted disaggregation of economic income should be developed, based on differentiated implications for predicting future cash flows. In this regard:

- (a) seeking to identify what should be included in a ‘primary’ measure (sub-set) of financial performance, such as profit or loss (which the DP seems to demonstrate is inherently difficult), seems inconsistent with the fact—acknowledged by the DP—that performance is not limited to an entity’s income and expenses [paragraph 8.17 of the DP says other changes in financial position (such as changes in an entity’s financial leverage) are also

aspects of performance]. A multi-faceted disaggregation of comprehensive income would be more consistent with that broad view of performance;

- (b) as noted in paragraph A51 below, the DP states that items in profit or loss have a greater information value for predicting future cash flows than items in OCI. Therefore, it argues, distinguishing profit or loss from OCI helps users of financial reports to predict an entity's future cash flows (paragraphs 8.43 and 8.46). However, the AASB considers that adopting a multi-faceted disaggregation of economic income, complemented by disclosure of other information relevant for assessing the entity's prospects for generating future cash flows (such as risk disclosures and disclosure of information about changes in the entity's economic environment) would have greater information value for predicting an entity's future cash flows than the approach developed in the DP. This is because the AASB considers that a dichotomy of income and expense items between those that are 'more predictive' and 'less predictive' of future cash flows is a crude tool for assisting users to predict future cash flows. In addition, the AASB considers that a multi-faceted disaggregation of economic income would be more representationally faithful of the continuously variable, rather than discrete, nature of the predictive value of different items of income and expense. [Nevertheless, the AASB would not object to presenting totals for 'profit or loss' and 'OCI' as part of a multi-faceted disaggregation of economic income, that is, without indicating that profit or loss (stripped of items presented in OCI) is the primary measure of financial performance.]; and
- (c) the AASB would support changes in assets and liabilities (including remeasurements and consumptions based on consistently determined measurement attributes recognised in economic income being disaggregated according to their differentiated implications for predicting future cash flows, but, as discussed in paragraph A63 below, the AASB would not conceptually support splitting those remeasurements according to different measurement attributes. For example, the AASB would not support bifurcating depreciation into historical cost and revaluation components, which Approach 2B to OCI would seem to accommodate (see paragraph 8.82 of the DP).

A49 As mentioned in paragraph A44(a) above, the AASB is not convinced of the merits of introducing a notion of OCI to the IASB Conceptual Framework. The existing Framework (paragraph 4.24) has an all-inclusive notion of profit or loss³¹ (i.e. that notion includes all items of income and expenses). It also says income and expenses may be presented in the income statement in different ways to provide information relevant for economic decision making (paragraph 4.27), and that "Distinguishing between items of income and expense and combining them in different ways also permits several measures of entity performance to be displayed." (paragraph 4.28) The AASB's view described in paragraph A44(a) above is consistent with these aspects of the existing Framework.

³¹ Termed 'profit' in the existing Framework.

Lack of an integrated theory of presentation of financial performance

A50 In relation to paragraph A47(b) above, the AASB notes that the notion of OCI was not developed as part of an integrated theory of presentation of financial performance. Rather, the inclusion of OCI in IFRSs was a pragmatic and piecemeal response to particular circumstances—that is, OCI was developed as a label to accommodate standards-level decisions to exclude particular disparate items from profit or loss in response to concerns voiced by constituents, for example:

- (a) exchange differences arising on monetary items forming part of a net investment in a foreign operation;
- (b) unrealised gains on available-for-sale marketable securities; and
- (c) gains/losses on financial instruments that hedge cash flows (the latter of which is a consequence of the non-conceptual nature of hedge accounting: see comments in paragraph A73 below).

This is reflected in the difficulty of enunciating a coherent theory for OCI—which is evident in the complex and ad hoc approaches to OCI discussed in Section 8 of the DP—and the continuing lack of a comprehensive model for classifying items of income and expense according to their differentiated implications for predicting future cash flows.

Lack of a coherent classification principle

A51 As mentioned in paragraph A47(c) above, the AASB considers that the DP does not establish a coherent principle for determining when it is more relevant to present an item in OCI rather than profit or loss. In this regard, the AASB acknowledges that the DP says:

“the profit or loss total or subtotal has more predictive value [of future net cash inflows] than total comprehensive income” (and, by implication, than OCI) [paragraph 8.20(b)³²]

“Recognising an item of income or expense in OCI will enhance the relevance of profit or loss if that:

- (a) makes the return on economic resources presented in profit or loss more understandable, ie makes the different components of a single item of income or expense more transparent; or
- (b) enhances the predictive value of items in profit or loss.”³³
(paragraph 8.46)

³² The IASB noted this argument in paragraph 8.20(b) and endorsed it in paragraph 8.22 of the DP.

³³ In this regard, the AASB notes that paragraph 8.20(c) of the DP also acknowledges the argument that profit or loss can be aligned more closely to an entity’s business model than total comprehensive income and therefore provide information from the perspective of management about how the entity’s resources have been used. In addition, consideration of an entity’s business model in determining whether to

A52 However:

- (a) in relation to (a) in the quote in paragraph A51 above, it is unclear to the AASB why bifurcation of income and expenses between profit or loss or OCI would necessarily aid understandability in a way that disclosure could not (in the context of that bifurcation being more than a matter of disclosure³⁴). In addition, the AASB did not find significant elaboration of the comment about understandability (in paragraph 8.46(a) of the DP) elsewhere in Section 8 of the DP, except in relation to enhancing understandability by classifying information about items of income and expense mainly according to its predictive value³⁵. For this reason, the AASB reached the view that the more pervasive factor identified in paragraph 8.46 of the DP for classifying items of income and expense in profit or loss or OCI is that referred to in paragraph 8.46(b), namely, enhancing the predictive value of items in profit or loss (see comments in paragraphs A52(b) – A61 below); and
- (b) in relation to (b) in the quote in paragraph A51 above, the AASB considers that the DP lacks a coherent principle for determining *how* to separate recognised items of income and expense into two categories with distinctly different information value for predicting an entity's future cash flows. This is illustrated in paragraphs A54 – A61 below. Furthermore, the AASB considers it is unlikely that such a coherent principle could be developed, given the range of ways in which economic income could (and should) be classified with differentiated implications for predicting the amount, timing, uncertainty and velocity of the entity's future cash flows. This concern of the AASB is supported by the comment in paragraphs 8.37 and 8.38 of the DP that the IASB believes, of the possible attributes for distinguishing between profit or loss and OCI set out in Table 8.1 of the DP, no single attribute can operationally and meaningfully make that distinction. The AASB considers there is a logical disconnect between that statement in paragraphs 8.37 and 8.38, and the preliminary views that the Conceptual Framework should distinguish profit or loss and OCI. As noted in paragraph A48 above, the AASB considers that, instead, it would be logical to support in concept a multi-faceted disaggregation of economic income.

present an item of income or expense in profit or loss or OCI is mentioned in paragraphs 8.57 and 9.33(c), and Table 8.4, in the DP. However, the AASB regards the information value of the consequences of an entity's business model to be a component of the value of information for predicting the entity's future cash flows: therefore, the AASB does not regard an entity's business model to be a separate principle in this context.

³⁴ That is, in the context of the preliminary view (set out collectively in paragraphs 8.40(a) and 8.81(a) of the DP) that profit or loss provides the primary source of information about an entity's return on its economic resources.

³⁵ Paragraphs 8.6 and 8.7 of the DP refer to enhancing understandability by classifying information about items of income and expense according to its predictive value, including presenting those items in a way that makes the variability of returns understandable. Paragraph 8.90 of the DP gives an example in which it is asserted that excluding a particular remeasurement from profit or loss would differentiate the remeasurement from items in profit or loss that have more predictive value, making profit or loss more understandable.

- A53 Notwithstanding the AASB’s disagreement in principle with necessarily bifurcating economic income into profit or loss and OCI, the AASB tested its view against the approaches to OCI discussed in Section 8 of the DP, to see whether its concerns were well founded, and concluded that they are. Because of the IASB’s preliminary view not to adopt ‘Approach 1 to OCI’, the AASB focused on Approaches 2A and 2B to OCI. Paragraphs A54 – A67 below identify preliminary views and related rationale in the DP that the AASB considers to illustrate the inherent problem with attempting to develop a coherent principle for bifurcating economic income into profit or loss and OCI.
- A54 As mentioned in paragraph A52(b) above, the AASB considers that the DP lacks a coherent principle for determining *how* to separate recognised items of income and expense into two categories with distinctly different information value for predicting an entity’s future cash flows³⁶. The DP seems to emphasise the following factors in identifying information with distinctly lesser information value for predicting an entity’s future cash flows (and therefore belonging in OCI):
- (a) the recognised item of income or expense is a remeasurement that is volatile to a significant degree—for example, it is unlikely to persist or recur or is subject to future changes in estimates or prices [paragraph 8.20(b) of the DP]. This type of remeasurement includes ‘transitory remeasurements’, which would be recognised in OCI under ‘Approach 2B’ and are likely to reverse or significantly change in either direction [paragraph 8.88 of the DP]³⁷;
 - (b) the recognised item of income or expense is unrealised (i.e., in general, this means the item did not arise from a transaction or a consumption of an asset in the form of depreciation/amortisation or an impairment) [see paragraph A57 below]; and
 - (c) the recognised item of income or expense is a ‘mismatched remeasurement’, i.e. it arises from a remeasurement and is linked with an asset or a liability that is not remeasured or is not recognised until a later period (paragraph 8.62 of the DP). Given the narrow range of items that seem likely to qualify as mismatched remeasurements, such remeasurements are not commented on below.

Volatility and realisation

- A55 In relation to the DP treating ‘volatility’ of an item of income and expense as a factor in identifying information with distinctly lesser information value for predicting an entity’s future cash flows (and therefore belonging in OCI) [see

³⁶ For example, paragraph 8.49 of the DP says that, in relation to a debt instrument measured at fair value, changes in some of the factors that contribute to the fair value of the instrument may have different predictive values, without explaining why.

³⁷ Volatility seems to be the key characteristic of ‘transitory remeasurements’. The restriction of such remeasurements to long-term assets and liabilities [under paragraph 8.88(a) of the DP] seems to be more a scope delimiter than an aspect of the nature of items of income and expense that have less predictive value of future cash flows, bearing in mind that, under Approach 2B, ‘transitory remeasurements’ would complement ‘bridging items’ and ‘mismatched remeasurements’ within OCI.

paragraph A54(a) above], the AASB considers that the DP is inconsistent in limiting this factor to remeasurements. (In addition, the AASB notes that this factor apparently would not apply to all remeasurements: see paragraphs A58 – A59 below.) This is because:

- (a) various items of income and expense arising from (historical) ‘cost-based measurements’ can be subject to significant volatility (see paragraph A56 below); but
- (b) the DP includes a preliminary view that all items of income and expense resulting from (historical) cost-based measurements should, in concept, be presented in profit or loss (paragraph 8.47).

A56 In relation to paragraph A55(a) above, examples of items of income and expense that arise from (historical) ‘cost-based measurements’ and are subject to significant volatility (including non-recurrence) are:

- (a) expenses recognised in respect of restructurings, unusual impairment losses³⁸, abnormal production costs of inventories resulting from a prolonged strike, one-off levies imposed by government and legal disputes; and
- (b) income recognised in respect of one-off government grants, and sales that occurred during the period and are likely to vary considerably in amount in future periods due to entry of a major competitor to the same market.

A57 Disregarding volatility in relation to items of income and expense resulting from (historical) cost-based measurements and including all such items in “the primary source of information about the return an entity has made on its economic resources” [paragraphs 8.40(a) and 8.81(a)³⁹] seems to strongly imply income and expenses resulting from (historical) cost-based measurements [often called ‘realised income and expenses’] inherently possess more information value for predicting an entity’s future cash flows than income and expenses arising from remeasurements⁴⁰. The AASB would not agree with such a characterisation of ‘realised income and expenses’, because realised income and expenses would not reflect the needs of users of financial reports to make investment and credit decisions using current period information under conditions of uncertainty regarding the ultimate outcome of economic events (i.e. changes in prices of assets and liabilities) affecting an entity. Information about realised outcomes can be irrelevant to such economic decision making because it lacks timeliness, especially if those realised outcomes occur many periods after the changes in prices of the entity’s assets and liabilities. The AASB considers that, if the IASB concludes that ‘realised income and expenses’ inherently possess more information value for predicting an entity’s

³⁸ Paragraph 8.51(c) of the DP says changes in cost-based measurements, such as impairments of assets, would not be recognised in OCI.

³⁹ Although this position is identified as a principle within possible Approaches 2A and 2B to OCI discussed in the DP, paragraph 8.46 indicates this position is the tentative view of the IASB.

⁴⁰ This impression is reinforced by the comment in paragraph 8.48 of the DP that some remeasurements may not have the same predictive value as (historical) cost-based information.

future cash flows than income and expenses arising from remeasurements, the IASB should explain how ‘realised income and expenses’ would provide a more useful basis for assessing the amount, timing and uncertainty of future cash flows. In this regard, the AASB observes that (as is effectively acknowledged in Table 8.1 on page 158 of the DP) entities can ‘cherry pick’ which assets to sell and when to sell them, and therefore selectively influence the amounts of gains or losses recognised during a period.

A58 In illustrating the comment in paragraph A47(c) above that the DP does not establish a coherent principle for determining when it is more relevant to present an item in OCI rather than profit or loss, paragraphs A55 – A56 above note the AASB’s concern that the DP does not seem to consistently apply the notion that the ‘volatility’ of an item of income and expense arising from a remeasurement of an asset or a liability is a factor in identifying information with distinctly lesser information value for predicting an entity’s future cash flows (and therefore belonging in OCI). A related concern of the AASB is that the DP seems to argue that:

- (a) changes in current market prices of derivative instruments (other than those used as hedging instruments) should be recognised in profit or loss due to the significant variability in their potential cash flows (paragraphs 6.89 – 6.90 and 8.63 of the DP); but
- (b) under ‘Approach 2B to OCI’, remeasurements of net defined benefit assets or liabilities due to changes in volatile market-based inputs, such as interest rates, should be recognised in OCI if, among other things, “the current period remeasurement is likely to reverse fully, or significantly change (in either direction), over the holding period of the asset or liability” (paragraphs 8.72 and 8.88(b) of the DP).

A59 It seems unclear what the economic drivers of these different conceptual treatments would be. Recognition of the remeasurement of a net defined benefit liability in profit or loss would not occur under Approach 2B if, among other things, the remeasurement is less predictive of future returns [implicitly, less predictive than an historical cost-based measurement] (paragraph 8.86 of the DP). However, the remeasurement of a non-hedging derivative instrument apparently would not be subject to a ‘predictive’ test (regarding future returns) for classification in profit or loss, even though it is inherently unpredictable in what directions and amounts those derivative remeasurements might recur. The apparent proposed treatment of remeasurements of derivatives in the DP is consistent with the widely accepted view that such remeasurements are important to include in profit or loss because of the potential effects of derivatives on an entity’s prospects and even its viability. However, changes in discount rates affecting a net defined benefit liability can also have serious implications for an entity’s prospects, and even its viability. Excluding resulting remeasurements of such a liability from profit or loss on the grounds that it is likely that it will reverse fully bases exclusion from profit or loss on expectations about the future, which might be unfounded. In this regard:

- (a) few would argue that remeasurements of derivatives should be excluded from profit or loss on the basis of expectations about future events; and
- (b) it would not be representationally faithful of the economic phenomena affecting an entity to recognise in profit or loss a reduction in a net defined benefit liability (an item of income) resulting from a reduction in projected future salary increases, but to exclude from profit or loss an increase in that liability (an expense) resulting from a reduction in discount rates, if both reductions have the same underlying cause: a decline in economic activity (e.g. due to a global financial crisis).

A60 In relation to the example of a net defined benefit liability discussed in paragraphs A58 – A59 above, or any other type of long-term provision⁴¹, the policy in Approach 2B that a current period remeasurement could⁴² qualify as an item of OCI if it is likely to reverse fully, or significantly change (in either direction), over the holding period of the asset or liability, the AASB also observes that:

- (a) significant shifts in interest rates can persist for far longer, or reverse more weakly, than initially expected (e.g. the reduction in interest rates in response to the global financial crisis). Therefore, any reversal of a shift in interest rates might occur too late, or to an insufficient extent, to significantly mitigate the effect of that interest rate shift on the burden represented by the net defined benefit liability at any time preceding its extinguishment (i.e. the expense arising from remeasuring that liability because of the shift in interest rates would not be mirrored to a significant extent by income from subsequently remeasuring the liability before it is extinguished); and
- (b) remeasurements of various long-term provisions tend to trend in one direction rather than reverse over time⁴³. Nonetheless, under Approach 2B, such remeasurements apparently could be recognised in OCI if they are likely to significantly change (although, as noted in paragraph A62 below, it is unclear to the AASB whether different components of a remeasurement of a provision might be treated differently under that Approach to OCI). Given that paragraphs 8.91 – 8.92 of the DP canvass the possibility of not recycling remeasurements of net defined benefit liabilities recognised in OCI under Approach 2B, the AASB is strongly concerned that (for example) expenses from remeasuring long-term provisions might never be recognised in profit or loss, even when they persist strongly^{44 45}. It is implicit in the term ‘transitory remeasurements’ that the remeasurements are temporary and thus do not have significant implications for predictions of the entity’s future

⁴¹ The AASB considers that the economic characteristics of various employee benefit liabilities, such as net defined benefit liabilities, are substantially the same as those of provisions.

⁴² i.e. subject to meeting the ‘enhanced relevance’ test in paragraph 8.88(c) of the DP.

⁴³ The AASB acknowledges there are exceptions to this tendency, e.g. where technological breakthroughs cause significant reductions in the cost of remediating environmental damage.

⁴⁴ i.e. in terms of the academic accounting literature, they have strong ‘earnings persistence’, and therefore have strong implications for assessing the entity’s future cash flows over the long term.

⁴⁵ However, as noted in paragraph 23(b) above, the AASB would not support recycling. Its strongly preferred approach to recycling is set out in paragraph 25 above.

cash flows. However, for many long-term provisions, that term could be a misnomer, in which cases the rationale for treating their remeasurements as OCI is undermined.

- A61 These observations in paragraph A60 above illustrate a weakness of bifurcating items of income and expense into those providing ‘greater’ or ‘lesser’ information value for predicting future cash flows, based on assumptions about what might occur in the future. The AASB considers a more robust approach to helping users of financial reports to make predictions about future cash flows is, as argued in paragraph A48(b) above, to complement a multi-faceted disaggregation of economic income with disclosure of other information relevant for assessing the entity’s prospects for generating future cash flows (such as risk disclosures and disclosure of information about changes in the entity’s economic environment).

Approaches 2A and 2B to OCI

- A62 Various of the AASB’s concerns discussed in paragraphs A47 – A61 above are based on the DP’s discussion of Approaches 2A and 2B to OCI. Paragraphs A63 – A67 below discuss in more detail some specific aspects of those Approaches that give rise to strong concerns of the AASB, in the context of the IASB’s preliminary view that one of those Approaches should be adopted in the IASB Conceptual Framework. The AASB finds it difficult to comprehensively evaluate Approaches 2A and 2B, because those Approaches focus on particular components of changes in assets and liabilities (such as changes in discount rates) without explaining how the other components of those changes should be classified (as profit or loss, or OCI). For example, the AASB finds it difficult to identify from the DP how components of remeasurements of provisions would be classified under those two Approaches (e.g. would changes in estimated cash flows be recognised in profit or loss and changes in discount rates generally be recognised in OCI—and if so, would a risk adjustment be treated differently according to whether it is included in estimated cash flows or the discount rate?).

‘Bridging items’ (Approaches 2A and 2B to OCI)

- A63 The AASB strongly disagrees with adopting the concept of ‘bridging items’, discussed in paragraphs 8.55 – 8.61 of the DP, which are an integral part of Approaches 2A and 2B to OCI. Measuring an asset or a liability on different bases in the statement of financial position and in profit or loss would be incompatible with depicting economic phenomena consistently in both places and would divide measurement attributes into economically meaningless components. This is because the measurement of assets and liabilities in the statement of financial position depicts the entity’s wealth embodied in those economic phenomena; any change in assets or liabilities (item of income or expense) recognised in total economic income (and any sub-classification of total economic income) should, in concept, include changes in that wealth measured on the same basis as the assets and liabilities to which that change relates. To disaggregate any of those changes in wealth between consecutive statements of financial position, into profit or loss and OCI components, represents accounting responses, not changes in economic

phenomena. For example, if, under Approach 2B in particular⁴⁶, profit or loss were to include the historical cost depreciation of a revalued item of property, plant and equipment (with the remainder of depreciation recognised in OCI), profit or loss would measure the consumption of service potential embodied in the depreciable asset inconsistently with the measurement of that service potential in consecutive statements of financial position. Thus, the ‘historical cost’ component of total depreciation recognised in respect of the asset for the period would have an accounting meaning but would not correspond to the economic phenomena depicted in the financial report⁴⁷. The consumption of an economic resource depicted in a financial report can in concept possess only one measurement attribute (i.e. the measurement attribute for the economic resource in the statement of financial position).

Approach 2B to OCI

- A64 Paragraphs A65 – A67 below set out some concerns the AASB has with Approach 2B to OCI. They are mentioned here because the AASB considers them indicative of its more general concerns about the lack of logical consistency and rigour of the DP’s discussion of how to distinguish profit or loss from OCI⁴⁸.
- A65 The AASB notes that Approach 2B appears to include little constraint on the items that might qualify for inclusion in OCI. Approach 2B relies, in part, on assumptions about whether remeasurements are likely to reverse or significantly change (in either direction) over the holding period of the asset or liability (paragraph 8.88(b) of the DP). As mentioned in paragraph A60(a) above, some changes (e.g. in exchange rates and discount rates) persist in unexpected ways. In addition, it is not apparent why an expected future significant remeasurement in the same direction would reduce the relevance to resource allocation decisions of recognising a current period remeasurement in profit or loss (although, under paragraph 8.88(b), such an expectation would be a basis for recognising the remeasurement in OCI); one might have expected it to *enhance* the relevance of recognising the current period remeasurement in profit or loss. It seems that virtually any remeasurement of a long-term item could be regarded as meeting the criteria in paragraph 8.88 of the DP for recognition in OCI as a ‘transitory remeasurement’. For example, exchange differences on a long-term borrowing in a foreign currency arguably could potentially meet the criteria.

⁴⁶ As mentioned in paragraph A48(c) above, Approach 2B to OCI would seem to accommodate the bifurcation mentioned in this sentence if it were considered to provide relevant information (see paragraph 8.82 of the DP). However, paragraph 8.75 of the DP seems to indicate that such bifurcation would not qualify as a bridging item of OCI under Approach 2A.

⁴⁷ This is a different issue from the AASB’s general concern about the relevance of measuring expenses on an historical cost basis, discussed in paragraph B119 of Appendix B below.

⁴⁸ In view of the difficulty under Approach 2A to OCI of treating as OCI some items of income and expense currently, or proposed to be, recognised in OCI (e.g. remeasurements of net defined benefit assets and liabilities, and of designated investments in equity instruments, as referred to in Table 8.2 and paragraphs 8.72 – 8.74 of the DP), and because Approach 2B to OCI would allow a broader range of items of income and expense (i.e. including ‘transitory remeasurements’) to be recognised in OCI (as referred to in paragraphs 8.84 and 8.90 of the DP), the AASB considers that any significant concerns with Approach 2B reflect on the DP’s overall approach to profit or loss and OCI.

A66 Another example of how virtually any remeasurement of a long-term item could apparently be regarded as meeting the criteria in paragraph 8.88 of the DP for recognition as a ‘transitory remeasurement’ in OCI under ‘Approach 2B’ is impairments of long-lived assets. Given that impairments of assets are based on current value measures (e.g. under paragraph 6 of IAS 36 *Impairment of Assets*, they are based on the higher of fair value less costs to sell and value in use), the AASB thinks impairments of ‘long-term’ assets would arguably meet the criteria in paragraph 8.88 for classification in OCI, if such classification is considered to enhance the relevance and understandability of profit or loss as the primary indicator of the return the entity has made on its economic resources. (As mentioned in paragraph A56(a) above, if volatility of other current value remeasurements is considered to warrant their exclusion from profit or loss, it would appear that such a conclusion would logically imply that impairments should be excluded from profit or loss for volatility reasons.) In this regard, it should be noted that impairments of depreciable assets would, in effect, reverse in future periods through reduced depreciation expenses (based on the reduced carrying amounts of the assets), thus apparently satisfying the criterion in paragraph 8.88(b) of the DP for classification in OCI as a ‘transitory remeasurement’. Deeming impairments to belong with (historical) cost-based measurements (paragraph 8.51(c) of the DP) is not a conceptual response to this issue.

A67 Given the potentially very broad range of items that, under Approach 2B, could be recognised in OCI, the AASB is concerned that Approach 2B could result in a measure of profit or loss that provides a highly inadequate indication of the entity’s current period financial performance and prospects for generating future cash flows. In addition, the AASB thinks it is unlikely that these concerns could be overcome without changing the overall thrust of the DP’s preliminary views on distinguishing profit or loss from OCI.

Recycling

A68 As mentioned in paragraph A44(b) above, the AASB fundamentally disagrees with 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 subsequently be recycled in profit or loss. This is because:

- (a) items of OCI subsequently recycled into profit or loss do not meet the definitions of income and expenses when they are recycled, because changes in assets or liabilities do not occur when the recycling occurs (they occurred when the item of OCI was previously recognised); and, less importantly,
- (b) under Approach 2B to OCI, the DP does not establish a coherent principle for determining when it would provide relevant information to recycle a previously-recognised item of OCI to profit or loss (see paragraph A71 below).

A69 The AASB considers that introducing recycling to the Conceptual Framework would represent a significant backward step from the existing Conceptual Framework. This is because the existing Conceptual Framework identifies as

elements of financial statements only economic phenomena. Recycling would involve an entity reporting in its financial statements ‘events’ that are not economic phenomena of the period in which they are reported. It would involve recognising particular economic phenomena (inflows and outflows of economic resources) twice in one component or another of comprehensive income. As noted in paragraph A68(a) above, recycling those items would report as income and expenses in profit or loss items that are not inflows or outflows of economic resources of that period (because they occurred when they were previously recognised), and would thus confuse accounting responses with economic phenomena. As mentioned in paragraph A10(a) above, the AASB considers that weakening the Conceptual Framework’s commitment to reporting only economic phenomena affecting an entity would be a fundamental concern.

- A70 The AASB considers that the distinction between profit or loss and OCI, if made at all, should be a matter of sub-classification of items recognised and presented once (and only once) in the statement of comprehensive income. This view is generally consistent with ‘Approach 1’ discussed in paragraphs 8.25, 8.27 and 8.29 – 8.31 of the DP.
- A71 In relation to paragraph A68(b) above, the AASB observes that, under Approach 2B (unlike Approach 2A⁴⁹) it would not be necessary to subsequently recycle all items of income and expense recognised in OCI to profit or loss. Principle 3 set out in paragraph 8.83 of the DP says recycling occurs when and only when recycling results in relevant information, without providing guidance on when that would be the case.
- A72 The AASB also observes that paragraph 8.85 of the DP calls into question the logic of recognising at all some items of income and expense recognised in OCI. This is because that paragraph indicates some items of income and expense arising from remeasurements would be permitted to be recognised in OCI although they would never provide sufficiently relevant information to warrant recycling to profit or loss. This implies changes in values of some assets and liabilities are relevant for assessing an entity’s financial position but never sufficiently relevant to include in primary information about the entity’s return on its economic resources. The AASB would disagree with such a view for similar reasons to those given in paragraph A63 above for disagreeing with the concept of ‘bridging items’. [In addition, as noted in paragraph A44(a) above, at a more general level, the AASB disagrees with treating profit or loss (stripped of items presented in OCI) as providing the primary source of information about an entity’s return on its economic resources.]

AASB’s view on accounting for hedging instruments

- A73 As mentioned in paragraph A70 above, the AASB considers that, if profit or loss were to be distinguished from OCI, ‘Approach 1 to OCI’ should in concept be adopted (i.e. recycling should be prohibited). Paragraph 8.32 of the DP says:

⁴⁹ Under Approach 2A, the range of items of income and expense that might be recognised in OCI would be narrower than under Approach 2B, and the guidance for when those items must be recycled seems reasonably clear.

“Approach 1 prompts the important question: how best to present the results of cash flow hedge accounting”, and presents three possible approaches that might be taken. The AASB considers that, consistent (in substance) with the possible approach set out in paragraph 8.32(a) of the DP, all forms of hedge accounting should be excluded from the Conceptual Framework. Hedge accounting is an accounting response to shortcomings in accounting for economic phenomena (e.g. an accounting mismatch arising from an omission to remeasure both hedged and hedging instruments) or to hedging an economic exposure that does not relate to a recognised asset or liability (e.g. a hedge of a forecast transaction), and in either case is conceptually inappropriate. This is because hedge accounting nets flows of separate economic phenomena (i.e. changes in hedged and hedging items), and thus obscures the effects of the decision to hedge an exposure. The links between hedged and hedging items, including (respectively) unrecognised and recognised elements, should be disclosed in the notes.

A74 Consistent with its comments in paragraphs A44 – A73 above, the AASB does not support either of Approaches 2A and 2B to OCI.

APPENDIX B

The AASB's other highly significant concerns with the DP

[Paragraphs B1 – B86 omitted from this extract]

Section 6—Measurement

- B87 As mentioned in paragraphs 11 – 19, and paragraphs A18 – A38 of Appendix A, above in this submission, the AASB:
- (a) strongly disagrees with the preliminary view that a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
 - (b) recommends that the revised IASB Conceptual Framework identifies an ideal concept of 'wealth' rather than presuming a mixed measurement model in concept; and
 - (c) strongly disagrees with the preliminary views in paragraphs 6.16, 6.78 – 6.80 and 6.83 of the DP, which identify different measurement bases for particular assets according to whether those assets contribute *directly* or *indirectly* to the generation of future cash flows⁵⁰.
- B88 Paragraphs B90 – B141 below primarily discuss the AASB's concern in paragraph B87(c) above. They also include discussion of the AASB's view of an ideal concept of wealth, its reasons for which explain in part its disagreement with measuring assets differently according to whether they contribute *directly* or *indirectly* to the generation of future cash flows.

Basing measurement of an asset on whether it is expected to contribute directly or indirectly to the generation of future cash flows by the entity

- B89 As mentioned in paragraph 12 above, the AASB considers that a key objective of measurement concepts should be to identify measurement bases or attributes that provide the most useful information for predicting the entity's future cash flows.
- B90 The AASB strongly disagrees with the manner in which paragraphs 6.16, 6.78 – 6.80 and 6.83 of the DP elaborate on the preliminary view in paragraph 6.35(d)(i) of the DP, by stating that the selection of a measurement for a particular asset should differ according to whether that asset is expected to contribute *directly* or *indirectly* to the generation of future cash flows. In particular, the AASB strongly disagrees with the preliminary views in those paragraphs that:

⁵⁰ As indicated in paragraph 12 above, the AASB considers that the ideal measurement concept (e.g. basis) for an asset should (among other criteria) provide the most useful information for predicting the entity's future cash flows. Therefore, the AASB's strong disagreement with this preliminary view relates to the DP's conclusions regarding the measurement implications of whether assets are expected to contribute directly or indirectly to the generation of future cash flows by the entity.

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

B91 The AASB arrived at this disagreement with the preliminary views referred to in paragraph B90 above in light of the following inter-related factors:

- (a) the DP seeming, inappropriately, to treat fair value (current market selling price) as the only alternative to historical cost worth considering (see paragraphs B93 – B99 below);
- (b) identifying an ideal concept of wealth, as the AASB recommends, would not involve measuring assets differently according to whether they are expected to contribute *directly* or *indirectly* to the generation of future cash flows (see paragraphs B100 – B108 below);
- (c) the preliminary view appearing to be based on an inappropriate assertion about the events relevant for assessing an entity's future cash flows, which is both:
 - (i) seemingly inconsistent with Chapter 1 of the IASB Conceptual Framework; and
 - (ii) inappropriately narrow for helping investors and creditors make those assessments (see paragraphs B109 – B125 below); and
- (d) for the reasons in (c) immediately above, an entity's capacity to provide cash to investors and creditors is not limited to its economic resources that directly generate cash inflows.

B92 In summary, based on these factors, the most relevant measures of an entity's recognised assets do not depend on whether the assets contribute directly or indirectly to the generation of future cash flows. In addition, the AASB emphasises that a proposed exception to the preliminary view that the ideal measurement basis for an asset differs according to whether the asset contributes directly or indirectly to the entity's cash flows indicates the lack of robustness of this preliminary view. Specifically, the AASB notes that the DP includes a preliminary view that the measurement of financial assets held for collection should significantly depend on the degree of variability of the contractual cash flows (paragraphs 6.19 and 6.89(a) of the DP).

Apparent focus on fair value (exit price) as the only current value measurement

B93 The AASB considers that the DP seems to treat fair value (an exit price, as defined in IFRS 13) as the only alternative to historical cost worth considering. This is despite the statement in footnote 52 to paragraph 6.79 of the DP that:

“This Discussion Paper does not consider whether cost-based measurements should use the original cost or the current cost. In current IFRSs, cost-based measurements are generally based on original cost. As noted in Section 9, the IASB believes that issues relating to current costs, and to concepts of capital maintenance, are best discussed in the context of a possible future project to review the IASB’s existing requirements on accounting for high inflation.”

B94 Accordingly, for the purposes of the comments in the following discussion, the AASB has disregarded footnote 52. To do otherwise would lead the AASB to comment that the DP has not adequately laid out the issues (because the DP would have included current cost as a possible measure of ‘cost’, without exploring its fundamental difference [being a current value measure] from historical cost and providing views on when one measure of ‘cost’ is more appropriate than the other) and therefore the AASB could not make meaningful comments.

B95 The AASB’s reasons for its interpretation in the first sentence of paragraph B93 above are explained in paragraphs B97 – B98 below.

B96 The AASB construes comments in the DP that current market selling prices are not relevant for particular categories of assets to indicate the IASB’s preliminary view that, in concept, those assets should be measured at historical cost. This understanding of the IASB’s preliminary views is a fundamental reason for the AASB’s disagreement with the preliminary views described in paragraph B90 above. (The other fundamental reason is that, under any of the main concepts of wealth discussed in the academic accounting literature, the measurement of assets would not differ according to whether those assets contribute *directly* or *indirectly* to the generation of cash flows by the entity: see paragraphs B100 – B108 below.)

B97 Although paragraph 6.50 of the DP, in discussing different types of current market prices, says: “use of an entry price (for example, replacement cost) might provide more relevant information [than an exit price] when: (a) assets are held for use rather than for sale ...”⁵¹, the DP seems to counteract that by saying, in relation to subsequent measurement of assets held for use (in paragraph 6.79):

“Gains and losses due to changes in asset price may not be relevant unless they indicate impairments or reversals of impairments.” (i.e. commenting adversely on using any form of current market price for remeasuring these assets upward); and

⁵¹ Paragraph 6.50 of the DP also says using an entry price might provide more relevant information when: “(b) exit prices are unavailable or do not reflect orderly transactions between willing buyers and sellers”. Because those circumstances are standards-level implementation concerns, the AASB does not regard them as having conceptual significance.

“For assets used by the entity, cost-based measurements normally result in income and expenses that are more relevant and understandable than income and expenses generated by current market selling prices.”

- B98 Taken together, these comments seem to imply current market selling prices are the only conceptual alternative to historical cost, in relation to assets held for use⁵². In addition, the discussion of ‘cost-based measurements’ in paragraphs 8.47, 8.48 and 8.51 of the DP (regarding profit or loss and OCI) strongly implies a ‘cost-based measurement’ refers to historical cost, and does not encompass current cost. Therefore, notwithstanding ‘footnote 52’ of the DP, paragraph 6.79 seems to nullify the comment in paragraph 6.50 of the DP regarding using an entry price to measure an asset’s current market price. Furthermore, other references to current market prices in the DP imply the IASB is mainly thinking of exit prices in that context⁵³.
- B99 Given that ‘current cost’ (or ‘current market entry price’, as referred to in this submission) is one of the most important possible measurement bases, the AASB considers that the DP should have evaluated its conceptual merits. Consistent with paragraph B142 below, the AASB does not consider that the potential usefulness, in concept, of ‘current cost’ is limited to high inflation environments. For the reasons discussed in paragraphs B119 – B135 below, the AASB considers that current market entry prices (e.g. current market buying prices for assets) are, in concept, generally the most relevant prices for measuring assets and liabilities. Therefore, the AASB considers it is essential that current market entry price is thoroughly considered in developing the Exposure Draft of the IASB’s revised Conceptual Framework.

Adopting an ideal concept of wealth

- B100 The AASB agrees with the comments in Chapter 1 of the IASB Conceptual Framework (on the Objective of General Purpose Financial Reporting) that investors and creditors are interested in an entity’s prospects for generating cash flows (see paragraphs B110 – B113 below). However, the AASB considers that the measurement bases adopted in concept for assets and liabilities should not be focused primarily on the future cash flows those elements are expected to give rise to; to do so would be tantamount to valuing the entity. In this regard, the AASB agrees with the statement in paragraph OB7 of the IASB Conceptual Framework that:

“General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential

⁵² For example, impairments or reversals of impairments seem to be identified as relevant because they reflect either changes in net market selling prices or are explicitly measured by reference to estimated cash inflows (unlike current market buying prices).

⁵³ For example, paragraph 6.11 says “... the IASB could decide: (a) to measure all assets and liabilities at a current market price *such as* fair value” (emphasis added). Despite the italicised words in the quote indicating other current market prices could be considered, the remainder of paragraph 6.11(a) discusses current market prices only in terms of opportunity cost, which reflects exit prices. Another example is the second sentence of paragraph 6.16(b), which implies current market prices are alternative use (exit) values.

investors, lenders and other creditors to estimate the value of the reporting entity.”

- B101 Rather, the AASB considers assets and liabilities should be measured at amounts depicting an identified concept of wealth. Although some assets and liabilities, such as provisions, might be measured using present value techniques, such techniques should only be used to estimate an amount consistent with a particular concept of wealth. Under any particular concept of wealth, the distinction between assets that generate cash flows directly and assets that generate cash flows indirectly would not determine how particular assets are measured. This is explained in paragraphs B102 – B108 below.
- B102 The AASB considers that the present value of future cash flows relating to a recognised asset or liability is not a present attribute of that asset or liability. Those future cash flows are not only the result of the entity’s present financial position (economic resources and present obligations), but also the result of the entity’s future operations in dealing with its economic resources and present obligations (e.g. in transforming economic resources into saleable items). The academic accounting literature does not identify present value as a measurement basis that should be applied to all, or even most, assets and liabilities⁵⁴. This is because of:
- (a) the conceptual reason that present value is, of itself, a technique that does not describe a particular measure of the entity’s wealth. For example, consistent with the comments in the lead-in of this paragraph, future cash inflows are not a present economic phenomenon; assets represent a present capability to produce future inflows, which, depending on the concept of wealth adopted, might be measured in different ways (each of which generally is not a direct estimate of those future inflows). This is explained in paragraphs B104 – B106 below; and
 - (b) the practical reason that the present value of an asset forming a part of a cash-generating unit cannot be determined separately for the asset. (This practical reason has been widely discussed in the context of IFRSs, and therefore is not elaborated on in this submission.)
- B103 An example of the distinction described in paragraph B102 above is the distinction between the value of a licence to operate in a market (i.e. the present capability to contribute to generating future cash flows provided by the licence) and the present value of future cash flows expected from operating in that market for the period of the licence (none of those cash flows could legally be obtained without the licence). The current cost of the licence fee might represent a small proportion of the present value of future cash flows expected from operating in that market (e.g. the market is lucrative). Paying the licence fee removes a barrier to operating in the market; it does not of itself give rise to the cash flows from operating in the market. The amount by which the entity’s wealth has increased is the amount of the licence fee it no longer needs to pay. Except to the extent of having paid the fee, the entity is no better off than any other entity possessing the necessary economic resources to

⁵⁴ This is the case, notwithstanding that paragraph 4.55(d) of the IASB Conceptual Framework identifies ‘present value’ as one of the measurement bases employed in financial statements.

operate in the market (or the capability of acquiring those economic resources) – each such entity possesses a real option to operate in the market, but real options are not economic resources (they are a function of the entity’s economic environment).

- B104 In relation to the conceptual reason referred to in paragraph B102(a), the concepts of wealth generally debated in the academic accounting literature are invested money capital, operating capability and current cash equivalents commanded. These alternative concepts of wealth, which are described in paragraph 15 above, underpin the three measurement bases (other than ‘present value’) described in paragraph 4.55 of the IASB Conceptual Framework, namely, ‘historical cost’, ‘current cost’ and ‘realisable (settlement) value’, respectively.
- B105 The implications of the concepts of wealth referred to in paragraph B104 above for whether measurement bases for assets would differ according to whether those assets are expected to contribute directly or indirectly to the generation of future cash flows are noted in (a) – (c) below:
- (a) if recognised assets were measured at amounts representing the invested money capital embodied in them, they would not be remeasured (except, arguably, to recognise impairments of assets under a modified historical cost model). Thus, whether recognised assets are held to generate cash inflows directly or indirectly would, in concept, not affect the measurement basis applied to them;
 - (b) if recognised assets were measured at amounts representing the operating capability embodied in them, they would be remeasured to current cost at each reporting date⁵⁵ regardless of whether those assets are held to generate cash inflows directly or indirectly; and
 - (c) if recognised assets were measured at amounts representing the current cash equivalents they command, they would be remeasured to their net selling price at each reporting date regardless of whether those assets are held to generate cash inflows directly or indirectly. All recognised assets would be measured at the amount of cash flows they could generate, assuming their only form of generating cash is orderly disposal as at the reporting date.
- B106 None of the concepts of wealth mentioned in paragraph B104 above directly represents the cash flows the entity is expected to generate from using the recognised asset. An entity’s operating capability represents the inputs presently commanded by the entity in pursuing its objectives of providing goods and services, and consequently in generating cash flows. It does not directly measure those cash flows. An entity’s current cash equivalents commanded measure cash flows from disposing of assets and redeeming or transferring liabilities, rather than the cash flows the entity would generate through using assets or settling liabilities by honouring its promises through its own operations.

⁵⁵ Except when current cost exceeds recoverable amount

B107 Nevertheless, the AASB considers that the two ‘current value’⁵⁶ concepts of wealth (i.e. operating capability and current cash equivalents commanded) provide relevant information for assessing the entity’s future cash flows. Its reasons are discussed in paragraphs B117 – B138 below. The AASB’s preferred concept of wealth is discussed in paragraphs B126 – B141 below, after discussing the DP’s views of relevant information about an entity’s cash flows (some of the AASB’s comments on those views are pertinent to identifying an ideal concept of wealth).

B108 Because the AASB considers that the measurement of assets and liabilities should reflect a particular concept of wealth, the AASB disagrees with the preliminary view that recognition of changes in the value of an entity’s assets should be limited to when those assets are held to generate cash flows directly. The AASB’s other reasons for disagreeing with that preliminary view are set out in paragraphs B109 – B125 below.

Inappropriate view of relevant information about an entity’s cash flows

B109 The preliminary view that the selection of a measurement for a particular asset should differ according to whether that asset contributes directly or indirectly to the generation of future cash flows by the entity appears to be based on a view of relevant information about an entity’s cash flows that:

- (a) seems inconsistent with (narrower than) the view of such information expressed in IASB Conceptual Framework Chapter 1 on the Objective of General Purpose Financial Reporting (see, in particular, paragraph B112 below); and
- (b) is inappropriately narrow.

The AASB’s reasons for these closely related concerns are explained in paragraphs B110 – B125 below.

Relationship to the existing IASB Conceptual Framework

B110 Paragraph OB3 of the IASB Conceptual Framework (with which the AASB agrees) says:

“Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases.” (It also makes a similar statement about lenders and other creditors.)

⁵⁶ This submission refers to current values in relation to alternatives to historical cost. As is mentioned in paragraphs B93 – B99 above, notwithstanding footnote 52 to paragraph 6.79, the DP seems to generally imply current exit prices are the only alternative to historical cost worth considering. The AASB’s purpose of referring to ‘current values’ is to avoid being misconstrued as referring only to current exit prices.

B111 These statements in paragraph OB3 refer to users' resource allocation decisions depending on expected cash flows (or other distributions of assets) from the entity to them, and on economic benefits they may obtain from increases in the value of their investments in (or loans to) the entity (their 'interests'), i.e. without necessarily receiving a transfer of cash (or other assets) from the entity. However, increases in the value of their interests will generally reflect expectations about the entity's ability to ultimately provide cash or other economic benefits to prospective purchasers of those interests. In short, users are interested in the capacity of the entity to provide cash (or other assets) in relation to their interests. That capacity depends on the entity's prospects for generating cash flows, potentially over a long period of time. These points are consistent with the comments in paragraph OB3 that:

“Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity.”

B112 The AASB notes that paragraph OB19 of the IASB Conceptual Framework says:

“Information about a reporting entity's financial performance during a period may also indicate the extent to which changes in market prices or interest rates have increased or decreased the entity's economic resources and claims, thereby affecting the entity's ability to generate net cash inflows.”

B113 The AASB considers it is important to take a broad perspective of the statements in paragraph OB3 quoted in paragraphs B110 and B111 above: this broad perspective seems to be reflected in paragraph OB19 of the IASB Conceptual Framework (quoted in paragraph B112 above) but not in the DP. An entity's capacity to provide cash to investors and creditors is not limited to its economic resources that directly generate cash inflows. For example, an entity might increase its wealth significantly without increasing the value of its assets held to directly generate cash inflows (e.g. through holding indefinitely as an investment land that appreciates in value). The entity's ability to pay cash to its investors and creditors is nonetheless enhanced, because its ability to raise cash by selling that investment or by issuing debt or equity instruments is enhanced. Similarly, a decline in the entity's cash inflows from one period to the next might not signify a reduction in the entity's capacity to pay its investors or creditors.

Inappropriately narrow view of relevant cash flows

B114 The AASB considers that the cash flows investors and creditors expect to obtain from their interests in the entity would generally be affected by all of the entity's expected cash flows, not just discrete cash flows generated directly by particular assets. For example, investors often invest in interests in entities to benefit indirectly from the skills of management in marshalling and deploying economic resources (generally non-monetary/held-for-use assets) and creating synergistic

benefits by producing niche products, producing generic products more efficiently, creating new markets and/or marketing products more effectively⁵⁷. In view of the degree of specialisation of resources necessary for entities to pursue their objective of generating above-market⁵⁸ returns for the risks borne by investors, there is no logical reason why each asset should be measured in terms of the cash flows it can generate on a standalone basis.

B115 In addition, the AASB considers that quarantining changes in the value of an entity's economic resources to assets that generate cash flows directly would treat external charges for using an economic resource as more important than implicit 'internal charges' for using economic resources to support the generation of direct cash inflows by other assets. Various assets (e.g. specialised assets) generate greater cash flows indirectly through use in the entity's operations than they could generate by being sold or charged out directly for use by external parties. In a sense, the entity could be described as the 'best customer' for its own indirect cash-flow asset(s). It would not be representationally faithful to:

- (a) remeasure those assets if, irrationally, the entity were to hold those assets for sale or rental by external parties; but
- (b) not remeasure those assets if they are deployed for the use that maximises their contribution to the entity's cash flows.

Such a depiction would not represent faithfully the relative capabilities of the entity's economic resources to contribute to the generation of future cash flows.

B116 The AASB is also concerned that basing the measurement of an asset on whether it generates cash inflows directly or indirectly:

- (a) strongly implies a perspective that owners and creditors 'look through' their interests in the entity's assets to the direct cash flows each asset can provide to them. Such an implication would be inconsistent with the fact that owners and even creditors generally⁵⁹ do not have rights to cash flows from particular assets. That fact is consistent with the comment in paragraph BC1.8 of the Basis for Conclusions on Chapter 1 of the IASB Conceptual Framework that the vast majority of today's businesses have legal substance separate from their owners. Therefore, the above-mentioned implication of the preliminary view to base the measurement of an asset on

⁵⁷ Acknowledging the relevance of the value of economic resources capable of generating synergistic benefits is not synonymous with including those synergistic benefits in the measurement of assets. As mentioned in paragraph B100 above, the AASB considers that the measurement bases adopted in concept for assets and liabilities should not be focused directly on the future cash flows those elements are expected to give rise to.

⁵⁸ The AASB considers that each for-profit entity has a goal of generating, through synergies in marshalling and/or deploying economic resources, greater returns than those warranted for the risks borne by its investors. Otherwise, the entity would have no reason to have been created; investors could simply continue to invest in existing entities.

⁵⁹ "Generally" is used here because an entity might contract to provide a creditor with a share of cash flows from specifically identified assets.

whether it generates cash inflows directly or indirectly seems inconsistent with said paragraph BC1.8; and

- (b) seems inconsistent with the proposal to clarify the distinction between economic resources and obligations (on one hand) and the resulting flows of economic benefits (on the other) by removing references to ‘economic benefits’ from the definitions of an asset and a liability [see paragraphs 2.11 – 2.14 of the DP]. The proposed definitions of an asset, a liability and an economic resource refer (directly or indirectly) to rights or other sources of value that are capable of producing economic benefits, rather than referring to the resulting economic benefits. The AASB considers that, in concept, the definition of an asset and the measurement basis for the asset should be based on similar economic notions. Therefore, the AASB considers it inconsistent to emphasise that assets are capable of producing economic benefits (and are not the future inflows of economic benefits) while adopting a preliminary view that the relevance of a measure depends on whether it is directly associated with those future inflows of economic benefits (e.g. cash inflows).

Information relevant for predicting the entity’s future margins

B117 The AASB notes that paragraph 6.79 of the DP argues:

“Measuring at a current market price an asset that generates cash flows indirectly (for example, an asset used by the entity) does not necessarily provide the best information about the cash flows that the asset will generate. ... For assets used by the entity, cost-based measurements normally result in income and expenses that are more relevant and understandable than income and expenses generated by current market selling prices.”

B118 In that quoted text, paragraph 6.79 of the DP alludes to assessing the relevance of particular measures in terms of their effects on reported income and expenses. The AASB considers that information useful for predicting the entity’s future margins of cash inflows over cash outflows is, in turn, important for predicting future cash flows to investors and creditors. The AASB also considers that important information for assessing those likely future margins is income and expenses of the period⁶⁰.

B119 However, the AASB strongly disagrees with the DP’s statement that, for assets that generate cash flows indirectly, cost-based information is more relevant and understandable than current market prices for helping users predict the entity’s future cash flows. Assuming that current market prices are materially different from cost⁶¹, the AASB considers that historical cost is not useful for predicting

⁶⁰ Rather than cash inflows and outflows, because changes in assets and liabilities for the period generally provide a better indication of future cash flows—as seems to be acknowledged in paragraph OB17 of the IASB Conceptual Framework.

⁶¹ As mentioned in paragraph A34(a) above, the AASB recommends assuming that all conceptual alternatives considered in relation to an issue are materially different, to avoid blurring the distinctions

future cash flows, because it is a ‘sunk cost’. The AASB considers that *current margins* [i.e. the margin between current income (such as sales revenue) and related expenses measured using current input costs (such as current cost of goods sold)] are considerably more relevant for predicting an entity’s future margins than are *margins based on historical cost* measurements of expenses⁶², regardless of whether the assets consumed in generating that income contributed *directly* to the generation of cash inflows by the entity. This is because:

- (a) the measurement of the expenses reflects a current economic phenomenon, i.e. the measurement in current monetary unit terms of the consumption of an economic resource that presently exists [in contrast, measuring expenses in historical cost terms is the consumption of an amount (or, for a complex asset acquired over a period, the aggregate of amounts incurred at different past dates) carried in the accounting records that has no present economic significance. For example, that historical cost carrying amount does not represent the entity’s capacity to contribute to providing goods or services at the time the asset was consumed.]. When an economic resource is consumed in generating income, its then-existing service potential that is consumed is the amount by which the entity was better off, at that time, for possessing that resource⁶³. The margin on current market buying price reflects the entity’s decision to sell the asset at that time for the contracted price (this is relevant for assessing the entity’s current period performance regardless of whether the consumed asset will be replaced);
- (b) current margins mean that income and related expenses are measured using prices that exist at the same time (rather than comparing a current value of income with a measure of an expense that relates to prices of a previous period). In times of rising prices, comparing income measured in current prices with expenses measured at historical prices includes in reported margins an amount that results from omitting to previously remeasure the assets that are consumed (partially or wholly) during the current period. If two entities sell identical⁶⁴ products during times of rising prices but one of them turns over its inventory more slowly than the other, the entity turning

between those alternatives and help ensure the concepts are sufficiently robust to cater for a wide variety of circumstances. Accordingly, in the context of this comment, historical cost should not be regarded as potentially useful for predicting cash flows by fortuitously coinciding with a current market price (as may occur, for example, when assets were recently acquired).

⁶² The AASB acknowledges that paragraph 6.79 of the DP argues (historical) cost information for measuring income and expenses is more useful, in relation to indirect-cash-generating assets (such as assets held for use), than current market *selling* prices (without saying other current values would not be relevant). However, as mentioned in paragraph B93 above, the DP seems to generally imply current market selling prices are the only alternative to (historical) cost worth considering.

⁶³ That service potential is the capability, or access, to future cash flows that the economic resource embodies, and is represented by the resource’s current market buying price. The current market buying price of an economic resource represents the cost currently avoided by possessing the resource. In other words, this current market buying price is the amount by which an entity is better off by possessing the economic resource, because if the entity were deprived of the resource (through loss or other consumption), the entity could restore its access to future cash flows by incurring that price.

⁶⁴ That is, the items of inventory are identical except that they were acquired at different times by the two entities.

over its inventory more slowly would⁶⁵ show greater margins than the other. This difference in reported margins would not seem useful information for resource allocation decisions by users of those entities' financial reports; and

- (c) particularly importantly, current margins provide useful information for assessing the sustainability of the entity's margins, and thus of its current business model. This provides information about the entity's prospects for generating future cash flows that is not provided by comparing income in current prices and related expenses at historical prices. A margin of income over related expenses measured at historical cost is unlikely to be sustainable during times of rising input prices because, after economic resources are consumed, those resources are likely to need replacing (at higher prices) if the same business activity is to be continued. For example, consider an oil refining company that holds large volumes of refined oil when the prices of refined oil double within the current period (as may occur during an 'oil price shock'). Assume the current cost to buy unrefined crude oil plus the current cost of refining that oil (that is, the sum of market buying prices of the refined oil) jumps from CU40 to CU70 per barrel, and that the current selling price of the refined oil jumps from CU60 to CU105 per barrel. Reporting a margin of CU65 over cost (i.e. CU105 minus CU40) would seem unlikely to reflect the sustainability of the entity's current business model. When the entity sells the refined oil, under its current business model it would need to replace the refined oil at a correspondingly higher cost. The AASB considers that current market buying prices (the use of which would result in a sales margin of CU35, i.e. CU105 minus CU70) are the most useful information for assessing future market buying prices of resources used by the entity in producing its outputs, and hence future margins.

Information useful for predicting net cash inflows

- B120 Consistent with the foregoing comments, the AASB considers that the cash flows the entity is expected to generate may be signalled, to a significant extent, by the current value of assets that generate cash inflows indirectly. In this regard, the AASB considers it is important to bear in mind that changes in the values of some assets that generate cash flows indirectly may be relevant to assessments of the entity's ability to generate *net* cash inflows, even if those assets' expected generation of *gross* cash inflows is unchanged (see example in paragraphs B121 – B125 below).
- B121 The following example also illustrates that information about current values of assets helps investors assess expected returns on the current value of the amount invested in the entity's assets (which relates to the more general comments in paragraphs B126 – B135 below regarding the usefulness of remeasuring assets and liabilities to their current values).

⁶⁵ Assuming all other circumstances are the same.

An entity has a factory with a depreciated historical cost of 10 million currency units (CU), and a depreciated replacement cost (as a measure of the asset's fair value, using the cost approach in paragraphs B8 – B9 of IFRS 13⁶⁶) of CU15 million. Due to new laws, the entity installs new pollution control equipment to be entitled to continue to operate the factory. The cost of that new equipment is CU2 million. Assume that the entity would be unable to pass on to its customers the cost of the new equipment by charging higher prices. However, the operation in which the factory is deployed would remain profitable even if the factory were measured at depreciated replacement cost (an impairment would not arise).

Immediately after the equipment is installed, the factory has a depreciated historical cost of CU12 million and a depreciated replacement cost of CU17 million.

- B122 Before the law changed and the pollution control equipment was purchased, the depreciated replacement cost of CU15 million represented the amount the entity would need to invest in the factory to obtain its present capability to generate future cash inflows. The new depreciated replacement cost of CU17 million represents the revised amount the entity would need to invest in the factory to obtain its present capability to generate the same future cash inflows. Because of the new laws, a lower rate of rate of return would be generated on any present investment in the factory. At the same time, the cost avoided by possessing a legally compliant factory has increased by CU2 million to CU17 million. Measuring the factory at its depreciated replacement cost results in depreciation being measured at current value. As mentioned in paragraph B119 above, an advantage of measuring depreciation at current value is that it can more usefully be compared with related revenues (which are always measured in prices that pertain to the current period). Measuring the factory at a current value of CU17 million thus provides relevant and comparable information to investors and creditors.
- B123 In contrast, if the historical cost basis were applied:
- (a) a lower rate of return would also be reported, but the percentage reduction would be exaggerated because costs incurred at different dates would be summed; and
 - (b) the carrying amount of the factory would not represent the amount that would currently need to be invested in the cash-generating capability of the factory (it would be the sum of historical amounts invested, which has no particular economic meaning in present-day terms).
- B124 Therefore, measuring the factory at a current value (depreciated replacement cost)—including the change in current value from acquiring new equipment—provides additional useful information compared with measuring it on an historical

⁶⁶ IFRS 13 uses the term 'current replacement cost' in paragraph B8 of its Application Guidance. This submission refers to 'depreciated replacement cost', to reinforce that the amount includes accumulated depreciation (or amortisation).

cost basis, even though there is no change in expected gross cash inflows from the factory.

- B125 If the focus of measurement of assets were their estimated future cash inflows, as reflected in the DP's emphasis on whether assets generate cash flows directly or indirectly, the carrying amount of the factory arguably should not change as a result of installing the new equipment. Instead, the cost of the new equipment should be recognised as an expense. This treatment would not reflect the economic substance of the transaction, and would both understate the current period rate of return on capital and overstate future periods' rates of return on capital.

Ideal concept of wealth

Current market entry and exit prices of recognised assets and liabilities, and related concepts of wealth

- B126 For-profit entities are created and invested in with the aim of generating above-market returns for the risks borne by investors, generally by those entities adding value through creating or acquiring specialised inputs and/or through superior processes for utilising inputs (whether specialised or not) to create and sell outputs. In other words, as mentioned in paragraph B114 above, investors often invest in interests in entities to benefit indirectly from the skills of management in marshalling and deploying economic resources (often non-monetary/held-for-use assets) and creating synergistic benefits by producing niche products, producing generic products more efficiently, creating new markets and/or marketing products more effectively. The cash flows the entity may provide to its investors and creditors are, in aggregate, dependent on those synergies and other entity-specific factors (in addition to generic economic resources like interest-bearing deposits). However, as mentioned in paragraph B102 above, the wealth embodied in an entity's assets is not the present value of the cash flows those assets will generate. Instead, it is the capability to contribute to generating those cash flows.
- B127 For the reasons in paragraph B126, the entity's capability to provide outputs that generate cash flows depends significantly on entity-specific factors⁶⁷. In view of the degree of specialisation of economic resources necessary for entities to pursue their objective of generating above-market returns for the risks borne by investors, to provide the most useful information about the entity's prospects for generating future cash flows (see paragraph B133 below), an entity's recognised economic resources should be measured at market prices reflecting those entity-specific capabilities. Those market prices are current market buying prices (entry prices). In contrast, current market selling prices (exit prices) measure the values that other market participants would place on those economic resources in the context of their own needs. If, as would often occur, the entity using a specialised asset can derive greater benefits from the asset than other market participants, exit prices would not

⁶⁷ However, it should be borne in mind that some of an entity's economic resources will embody a capability to generate cash flows that does not depend on entity-specific factors (e.g. equity investments).

measure the asset's capacity to contribute to generating the entity's future cash flows.

B128 As mentioned in paragraph B106 above, the current market buying price of a recognised asset does not directly represent the cash flows the asset is expected to generate. However, it provides a current measure of the recognised asset that the AASB considers is the most useful for helping an entity's investors and creditors to:

- (a) assess the entity's current capacity to provide goods and services under the entity's current business model;
- (b) predict the entity's future cash inflows from future sales of the entity's products⁶⁸. For an entity with reasonably stable margins on current market buying prices of assets used to produce sales revenue, users of its financial reports can estimate future sales revenues by adding an estimated margin on current market buying prices;
- (c) predict the entity's future cash outflows from replacing assets (e.g. inventories, plant and equipment). This is because the best indicator of future replacement costs is current replacement costs; and
- (d) assess the entity's capacity to sustain its current business model (operational sustainability) [for the reasons in (b) and (c) immediately above and paragraph B133 below].

This would help meet important common information needs of investors and creditors in assessing the entity's capability to generate future cash flows.

B129 Similarly, the economic burden represented by an entity's non-monetary liabilities (e.g. performance obligations to customers and environmental restoration obligations) depends on entity-specific factors, because the efficiency with which the entity can discharge those obligations affects its future cash outflows. Consequently, an entity's non-monetary liabilities should be measured at market prices reflecting the entity-specific economic burden of those obligations. In other words, in concept they should be measured at the current market prices of the inputs needed for discharging those obligations. Often, this amount would be equivalent to the price the entity would presently demand in a market transaction to incur those obligations. For monetary liabilities (e.g. borrowings), the current economic burden they represent would reflect the contractual cash flows and therefore would not be entity-specific, except for transaction costs. Except for transaction costs and, possibly, the effect of own credit risk⁶⁹, the current market entry price and current market exit price for monetary liabilities would be the same.

⁶⁸ It should be borne in mind that future cash inflows from sales of the entity's products arise not only from existing assets but also from assets that the entity acquires or produces in the future (e.g. sales of minerals extracted in future periods).

⁶⁹ The AASB notes an argument that the effects of own credit risk on current market entry prices of monetary liabilities would be offsetting (i.e. an increased discount rate demanded by lenders would be accompanied by an increased amount of contractual cash flows in a replacement loan). The AASB also notes arguments that, if a monetary liability's current market exit price were measured at a current

B130 Historical costs would generally be less useful than current market buying prices for predicting the entity's future cash inflows from future sales of the entity's products, because:

- (a) as mentioned in paragraph B119(b) above, margins on historical costs would fluctuate according to how recently assets used in producing sales revenues were acquired (this is particularly important for long-lived assets like plant and equipment, which might have been acquired recently or many periods previously); and
- (b) historical costs would not necessarily⁷⁰ reflect recent changes in the entity's cost structure (e.g. through shifts in technology), which might, for example, lead to reduced selling prices for the entity's products – such changes would be reflected by current market buying prices.

Entity-specific capabilities are more generally relevant than financial flexibility for predicting future cash flows

B131 Entity-specific capabilities to generate cash flows generally involve significant investments in economic resources with limited alternative use (exit) value. Examples of such assets are self-constructed purpose-built equipment and employee facilities in a mining town. The ability to generate synergistic benefits through specialisation of capabilities comes at the price of financial flexibility—that is, the cost of exiting an activity and reinvesting in another is often prohibitively expensive and, therefore, such actions would be economically irrational. Fortunately for investors, financial intermediation in the form of well-developed equity markets provides financial flexibility to them at much less cost. In this regard, the ability of many investors to reallocate their economic resources by exiting their investments for minimal transaction costs should not be confused with the consequences of entities reallocating their economic resources by exiting their operations and reinvesting in different activities. Because, as mentioned above, it would often be economically irrational for entities to do so, choosing a measurement basis that assumes such divestment and reinvestment will occur would be unlikely to serve the common information needs of investors and creditors well. The above-mentioned distinction between the financial flexibility of investors and of the entities they invest in is consistent with the fact, acknowledged in paragraph BC1.8 of the Basis for Conclusions on Chapter 1 of the IASB Conceptual Framework, that the vast majority of today's businesses have legal substance separate from their owners. In

cancellation price (e.g. a current price for repurchasing the entity's own debt instruments), the entity's own credit risk would affect the measurement of that price. However, the entity's own credit risk would not affect the other possible measure of a monetary liability's current market exit price (i.e. the current price to transfer a liability to a third party), because the transferee would not reward the entity for any inferior credit standing. The AASB does not wish to express a conclusion on the treatment of own credit risk in measurement of monetary (or other) liabilities at this stage, but notes this issue as a potential source of difference between current market entry prices and current market exit prices for monetary liabilities.

⁷⁰ That is, they would only do so for assets acquired recently.

apparently treating fair value (an exit price) as the main alternative to historical cost, the DP seems to disregard that fact.

- B132 In relation to the discussion, in paragraphs B127 – B131 above, of the relevance of entity-specific factors to measuring an entity’s capability to contribute to the generation of cash flows, the AASB notes that some commentators argue that measures of assets and liabilities should exclude entity-specific factors because they consider that measures of assets and liabilities would provide more useful information if they reflect the perspective of any market participant. Some of these commentators argue that fair value (exit value) should therefore be preferred to current market entry price. However, in relation to assets and liabilities for which entity-specific factors arise (essentially non-monetary assets and liabilities), ‘fair value’ as defined in IFRS 13 encompasses entity-specific factors, notwithstanding the statement in paragraph 2 of IFRS 13 that: “Fair value is a market-based measurement, not an entity-specific measurement”⁷¹. Paragraph 32 of IFRS 13 says, in relation to a non-financial asset for which the highest and best use is to use it in combination with other assets, that “a fair value measurement assumes that the market participant already holds the complementary assets”, and paragraph BC78 of the IASB’s Basis for Conclusions on IFRS 13 says, in relation to specialised non-financial assets, that: “In effect, the market participant buyer steps into the shoes of the entity that holds that specialised asset.” The entity-specific nature of this principle is illustrated in paragraph B3(c) of the Application Guidance in IFRS 13, which says: “if the asset is work in progress inventory that is unique and market participants would convert the inventory into finished goods, the fair value of the inventory would assume that market participants have acquired or would acquire any specialised machinery necessary to convert the inventory into finished goods”.
- B133 For the reasons explained in paragraph B119, the AASB considers that margins between income and related expenses provide important information for assessing the entity’s efficiency in converting inputs to outputs and selling (and delivering) those outputs. Measuring at current value those inputs consumed provides useful information for assessing the sustainability of the entity’s margins, and thus of its current business model. In particular, the AASB considers measuring expenses using current input costs provides the most relevant and comparable information about the entity’s current margins, which in turn provides:
- (a) the most useful information for assessing the sustainability of the entity’s margins, and thus of its current business model (see also paragraph B128 above); and, consequently,
 - (b) highly useful information about the entity’s ability to pay cash to its investors and creditors.
- B134 These views of the AASB, regarding the usefulness to users of measuring assets and liabilities at current market entry prices (as set out in paragraphs B119 – B133

⁷¹ Current market buying prices are also market-based measurements, despite taking into account any entity-specific factors. The distinction between a current exit price and a current entry price relates to the different markets in which the relevant transactions would occur,

above) are supported by the findings of various academic studies (noted in paragraphs A36(c) – (e) and A37 of Appendix A above) that current market entry prices provide more relevant information than historical costs for predicting an entity's future cash flows, and are reflected in the pricing of entities' equity securities.

- B135 In contrast, measuring assets at current exit prices reflects other market participants' expectations regarding the cash flows they may generate with those assets in their own businesses; and changes in those exit prices provide information about changes in those expectations. Information about changes in expectations bears no logical connection to the relationship between the current values of the entity's inputs and outputs, information about which is vitally important for resource allocation decisions by investors and creditors. Exit prices of economic resources represent their opportunity cost. For assets that rationally would not be sold, because they can generate superior returns through the entity's use, measuring them at exit price would understate their capacity to contribute to generating cash flows. In addition, measuring the consumption of assets by reference to their opportunity cost provides less useful information about the entity's margins (than margins on current market buying prices) for assessing the entity's prospects for generating future margins (net cash inflows).

AASB's conclusion on an ideal concept of wealth

- B136 For the reasons in paragraphs B126 – B135 above, the AASB considers that the ideal concept of an entity's wealth that should be adopted in the IASB Conceptual Framework is operating capability, as described in paragraph 15(b) above.
- B137 An entity's operating capability represents the entity's capacity being utilised, in contrast with an entity's current cash equivalents commanded, which represent the entity's adaptive capacity (i.e. which relates to the entity's liquidity and capacity to finance alternative business models). Whilst the AASB considers information about an entity's adaptive capacity would be useful to investors and creditors in making resource allocation decisions (e.g. in assessing how the entity would be placed in coping with unexpected adverse events, and how nimble the entity might be in financing opportunities to undertake different activities), it considers it is more useful to measure the elements in the primary financial statements on the basis of the activities it currently undertakes. The AASB thinks information about adaptive capacity should be provided in notes.
- B138 In addition to providing, in the AASB's view, the most useful measures of assets and liabilities for helping meet the common information needs of investors and creditors in assessing the entity's capability to generate future cash flows (see paragraph B128 above), current market entry prices have the advantage of being more readily obtainable than current market exit prices. This is because entities regularly replace most of the economic resources they use, but only sell some of those economic resources. (The exception to this advantage is when entities buy and sell economic resources in the same market, in which instances information about current market entry prices and current market exit prices would be equally readily available.)

- B139 For the reasons discussed in paragraphs B119 – B124 above regarding the deficiencies of historical cost as a measurement basis in meeting the objective of providing information useful for resource allocation decisions by investors and creditors, the AASB does not support adopting the concept of wealth associated with historical cost: namely, invested money capital.
- B140 The AASB considers that adopting operating capability as the ideal concept of wealth would address, to a significant degree, the conceptual role of the entity's business model. An entity's operating capability takes into account how management has chosen to 'configure' the entity's capability to provide goods and services, while measuring it using current market buying prices⁷² (rather than ascribing the entity's own values to that capability⁷³). However, an entity's business model would not determine which measurement basis to apply, in concept, to an asset or a liability. Using an entity's business model to decide when to remeasure an asset or a liability would be incompatible with adopting operating capability (or, for that matter, any other current value) as the ideal concept of wealth. This view is consistent with the AASB's view that, in concept, historical cost is irrelevant as a measurement basis for assets and liabilities.
- B141 As indicated in paragraph B137, adopting operating capability as the concept of wealth for measuring recognised assets and liabilities would not meet all of the common information needs of investors and creditors. Nevertheless, the AASB considers that:
- (a) it is essential, in concept, to identify an ideal concept of wealth; and
 - (b) operating capability is the concept of wealth that best meets those common information needs.

Section 9—Other issues

Capital maintenance

- B142 The AASB strongly disagrees with the preliminary view in paragraph 9.49 of the DP that the topic of capital maintenance should be addressed at a standards level in the context of accounting for high inflation. This is because the AASB considers that:
- (a) concepts of capital maintenance are important regardless of the type of economic environment in which the reporting entity operates. Prices of particular assets and liabilities (for example, derivatives, raw materials and fixed assets in short supply, and items denominated in a foreign currency) can change significantly without a significant change in the general level of prices, and price changes that seem immaterial when looking at each

⁷² Current market buying prices are used, except when an asset's recoverable amount is less than its current market buying price.

⁷³ Current market buying prices represent the prices other market participants currently demand for providing the entity's economic resources.

reporting period separately can become cumulatively material over multiple reporting periods (e.g. over the lives of long-lived assets);

- (b) every measurement basis adopted for the various items in a set of financial statements, and the treatment of any changes in the carrying amounts of those items, implicitly reflects concepts of capital and capital maintenance. As mentioned in paragraphs 14 and A27 – A32 above, the AASB thinks it is preferable to have explicit coherent concepts of wealth and changes in wealth⁷⁴ ('capital' and 'capital maintenance') than implicit and potentially conflicting concepts for those matters; and
- (c) for the reasons in (a) and (b) immediately above, the issue is so pervasive that it should be addressed in the Conceptual Framework rather than a standards-level project.

B143 Paragraphs 8.75 – 8.76 of the DP (which discuss revaluations of property, plant and equipment) give, in effect, an example of how the IASB will face a difficult challenge to develop coherent concepts for presentation in the statement of comprehensive income without addressing concepts of capital and capital maintenance at a conceptual level.

B144 To illustrate more broadly the point in paragraph B143 above, consider the fact pattern in the oil refining company example discussed in paragraph B119(c) above. If the entity were to adopt a current value concept of wealth, in measuring its stocks of refined oil, it would need to choose between the current market buying price of CU70 per barrel and the current market selling price of CU105 per barrel. Assume for simplicity that (consistent with the AASB's view of the ideal concept of an entity's wealth) operating capability is adopted as the concept of wealth and the refined oil is remeasured to its current market buying price (CU70 per barrel). The entity then needs to decide whether the remeasurement of the refined oil from its opening current market buying price of CU40 (i.e. an increase of CU30 per barrel) should be included in economic income for the period or credited directly to equity as a capital maintenance adjustment. This decision should be based on the concept of economic income adopted. Under an operating capability concept of income, the increase in current market buying price of the refined oil would be credited directly to equity (as a capital maintenance adjustment) because it does not represent an increase in the entity's operating capability—it simply reprices the same service potential. Although the increase in current market buying price of the refined oil coincides with an increase in the current market selling price of the refined oil (thus increasing the margin on the historical cost of the oil), the company's ability to carry out its activities has not improved. This is because, when the entity sells the refined oil, it needs to replace the refined oil at a correspondingly higher cost.

⁷⁴ More specifically, the pertinent concept of changes in wealth is a concept of 'economic income' (income minus expenses), which is composed of changes in wealth arising from all transactions and other events excluding those resulting from transactions with owners acting in their capacity as owners. Therefore, this submission means a concept of economic income when it refers to the term 'concept of capital maintenance' used in the DP.

- B145 Varying the assumption made in paragraph B144 above regarding the concept of wealth adopted by the oil refining company in its financial report, assume instead that the concept of wealth adopted by the entity is current cash equivalents commanded. The refined oil would be remeasured from CU60 to CU105 per barrel. Under a current cash equivalents commanded concept of economic income, the CU45 per barrel increase in the current market selling price of the refined oil would be recognised in economic income because it represents an increase in the entity's current cash equivalents commanded. However, if, instead, the concept of economic income adopted were the general purchasing power of the entity's wealth (i.e. of its current cash equivalents commanded), and the economy in which the entity operates experienced an increase in the general level of prices, the entity would recognise both a CU45 per barrel amount of economic income and an expense for the loss in general purchasing power of the entity's opening wealth.
- B146 The AASB's concerns in paragraphs B142 – B143 above are not allayed by the proposal in paragraph 9.50 of the DP to retain the existing Conceptual Framework's discussion of concepts of capital maintenance largely unchanged until any project on accounting for high inflation indicates a need for change. This is because the discussion of concepts of capital maintenance in the existing Conceptual Framework is descriptive and does not indicate which concept of capital maintenance is conceptually ideal.
- B147 As implied by paragraph B142(b) above and illustrated in the example in paragraphs B144 – B145 above, a corollary of addressing in the Conceptual Framework the concept of capital maintenance (concept of economic income) is addressing first the overarching issue of the concept of capital (concept of wealth).
- B148 Another reason there is no need to defer consideration of concepts of capital and capital maintenance is the extensive literature that exists regarding these concepts.

Other Comments

- B149 The AASB notes that the discussion of some topics in the DP seems unduly restrictive, by focusing on particular discrete 'Views' or 'Approaches' without first discussing the spectrum of possible views within which those 'Views' or 'Approaches' belong. For example:
- (a) the discussion of OCI in Section 8 of the DP focuses on the components of particular 'Approaches', apparently without seeking to identify overarching concepts; and
 - (b) the discussion of subsequent measurement of assets and liabilities in paragraphs 6.73 – 6.109 of the DP focuses on approaches that do not consider concepts of wealth (or capital), although there is a considerable body of accounting literature on those concepts, as noted in paragraph B148 above.

APPENDIX C

How an ‘operating capability’ concept of wealth could be modified for application in IFRSs

Introduction

- C1 As noted in paragraph 17 and A21 above, the AASB considers that applying a modified ‘operating capability’ concept of wealth at a standards level is preferable to simply retaining (without a sufficient conceptual justification) the mixed measurement treatments in present IFRSs. The AASB’s preferred approach would have the advantages of:
- (a) using a single explicit and robust conceptual starting point;
 - (b) minimising the extent to which different concepts of wealth would be mixed (e.g. consistent discount rates would be used⁷⁵; and, when entity-specific cash flows are expected to differ from cash flows for other market participants, entity-specific cash flows would consistently be preferred⁷⁶)—which would help achieve the measurement qualities argued in paragraph 13 above of this submission (namely, that the amounts can meaningfully be added, subtracted and compared; and the economic significance of those amounts, individually and collectively, is capable of being understood);
 - (c) taking account of cost/benefit considerations and the capacity of preparers to meet financial reporting requirements given current limitations of technology and methodology; and
 - (d) signposting the direction in which measurement of assets and liabilities in financial reporting should ideally evolve.
- C2 To illustrate the AASB’s preferred approach, the Table in this Appendix shows examples of classes of assets and liabilities that illustrate and compare:
- (a) how those classes are currently required to be measured subsequent to initial recognition under current IFRSs;
 - (b) how those classes would be measured subsequent to initial recognition under strict application of an ‘operating capability’ concept of wealth; and

⁷⁵ In contrast, under IFRSs, one type of non-monetary liability (i.e. provisions) is discounted using a liability-specific rate whilst another type of non-monetary liability (i.e. post-employment benefits) is discounted at a rate that is not liability-specific (i.e. high-quality corporate bond rate, if a deep market in those bonds exists).

⁷⁶ It should be borne in mind that, for a range of assets and liabilities, e.g. equity instruments held and debentures owed, the entity’s resulting cash flows would not differ from the resulting cash flows for other market participants.

- (c) how the measurements identified in (b) might be modified if, hypothetically, that concept were adopted in IFRSs after taking into account practicability considerations.

- C3 In general, the Table demonstrates that applying a modified ‘operating capability’ concept of wealth in IFRS need not result in radical changes to IFRSs at this stage, but would achieve all of the advantages listed in paragraph C1 above.
- C4 The Table is not intended to be comprehensive and it identifies particular measurement approaches in IFRSs and IASB ED/2013/7 *Insurance Contracts* only in broad terms for illustrative purposes.

TABLE

Class of assets or liabilities	IFRS subsequent measurement	Strict application of ‘operating capability’ concept of wealth	Possible standards-level modified operating capability model (main modifications in italics)
Inventories	IAS 2 Lower of cost and net realisable value	Lower of current cost and net realisable value	Lower of <i>historical cost</i> and net realisable value, for inventories that turn over quickly; or Lower of current cost and net realisable value
Plant and equipment Intangible assets	IAS 16 & IAS 38 Cost less accumulated depreciation/amortisation and accumulated impairment losses; or Fair value less accumulated depreciation/amortisation and accumulated impairment losses (which could be a current replacement cost under IFRS 13)	Current cost less accumulated depreciation/amortisation and accumulated impairment losses	<i>Historical cost</i> less accumulated depreciation/amortisation and accumulated impairment losses; or Current cost less accumulated depreciation/amortisation and accumulated impairment losses
Land (PP&E)	IAS 16 Cost less accumulated impairment losses; or Fair value less accumulated and impairment losses	Current cost less accumulated impairment losses	<i>Historical cost</i> less accumulated impairment losses; or Current cost less accumulated impairment losses

Class of assets or liabilities	IFRS subsequent measurement	Strict application of ‘operating capability’ concept of wealth	Possible standards-level modified operating capability model (main modifications in italics)
Biological assets	IAS 41 Fair value less costs to sell	Current cost less accumulated impairment losses	Current cost less accumulated impairment losses
Investment properties	IAS 40 Cost less accumulated depreciation and accumulated impairment losses; or Fair value less accumulated impairment losses	Current cost less accumulated depreciation and accumulated impairment losses	<i>Historical cost</i> less accumulated amortisation and accumulated impairment losses; <i>or</i> Current cost less accumulated depreciation and accumulated impairment losses
Trade receivables Loan receivables	IAS 39 / IFRS 9 Amortised cost less impairments based on present value of cash flows discounted at the historical/contractual discount rate; or, based on specific criteria; Fair value	Lower of current market entry price for contractual cash flows and recoverable amount (present value of expected cash flows, discounted at a current market rate for the entity)	<i>Amortised cost</i> less impairments based on the present value of estimated cash flows discounted using an <i>historical contractual rate</i> , for receivables expected to be realised within a short period; <i>or</i> Lower of current market entry price for contractual cash flows and recoverable amount
Other financial assets: e.g. equity instruments	IAS 39 / IFRS 9 Fair value	Current market entry price	Current market entry price
Derivatives (assets or liabilities)	IAS 39 / IFRS 9 Fair value	Current market entry price	Current market entry price

Class of assets or liabilities	IFRS subsequent measurement	Strict application of ‘operating capability’ concept of wealth	Possible standards-level modified operating capability model (main modifications in italics)
Trade payables Loans payable	IAS 39 / IFRS 9 Amortised cost discounted at the historical/contractual discount rate; or, based on specific criteria Fair value	Current market entry price (replacement cost) for contractual cash flows (discounted at a current market rate) ⁷⁷	<i>Amortised cost discounted using an historical/contractual interest rate</i> , for trade or loan payables expected to be settled within a short period; <i>or</i> Current market entry price for contractual cash flows (discounted at a current market rate)
Short-term employee benefits	IAS 19 Current fulfilment value: the undiscounted amount expected to be paid in respect of services already received (using entity-specific cash flows)	Current fulfilment value: the present value of future amounts expected to be paid in respect of services already received (using entity-specific cash flows discounted at a current market rate)	The <i>undiscounted</i> amount expected to be paid in respect of services already received (using entity-specific cash flows); <i>or</i> The present value of future amounts expected to be paid in respect of services already received (using entity-specific cash flows discounted at a current market rate)
Long-term employee benefits	IAS 19 Current fulfilment value: the present value of future amounts expected to be paid in respect of services already received (using entity-specific cash flows discounted using yields on high-quality corporate bonds where an active market exists for those bonds, or the government bond rate)	Current fulfilment value: the present value of future amounts expected to be paid in respect of services already received (using entity-specific cash flows discounted at a current market rate)	Current fulfilment value: the present value of future amounts expected to be paid in respect of services already received (using entity-specific cash flows discounted at a current market rate)

⁷⁷ Consistent with the footnote to paragraph B129 in Appendix B above, the AASB does not wish to express a conclusion on the issue of the treatment of own credit risk in this context at this stage.

Class of assets or liabilities	IFRS subsequent measurement	Strict application of ‘operating capability’ concept of wealth	Possible standards-level modified operating capability model (main modifications in italics)
Provisions	<p>IAS 37</p> <p>Current fulfilment/transfer value</p> <p>That is, the present value of the best estimate of future amounts to be paid in settlement of the liability; or, where transfer is expected, in transferring the liability (using entity-specific cash flows discounted at a current market rate reflecting the risks specific to that liability)</p>	<p>Current fulfilment value: the present value of the best estimate of future amounts to be paid in settlement of the liability or, where transfer is expected, in transferring the liability (using entity-specific cash flows⁷⁸ discounted at a current market rate)</p>	<p>Current fulfilment value: the present value of the best estimate of future amounts to be paid in settlement of the liability or, where transfer is expected, in transferring the liability (using entity-specific cash flows discounted at a current market rate)</p>
Insurance contract liabilities	<p>IASB ED/2013/7</p> <p>Current fulfilment value:</p> <p>The present value of the best estimate of future amounts to be paid in settlement of the liability, discounted at a current market rate; incorporating an explicit margin for risk, and any contractual service margin. The contractual service margin element is subsequently amortised over the coverage period in the systematic way that best reflects the remaining services provided.</p>	<p>Current fulfilment value</p> <p>The present value of the best estimate of future amounts to be paid in settlement of the liability, discounted at a current market rate. The future amounts would include those in relation to risk and any amounts needed to fulfil the services to be provided under the contract(s).</p>	<p>Current fulfilment value</p> <p>The present value of the best estimate of future amounts to be paid in settlement of the liability, discounted at a current market rate. The future amounts would include those in relation to risk and any amounts needed to fulfil the services to be provided under the contract(s), <i>plus any remaining element of the contractual service margin that does not represent services to be provided under the contract(s).</i></p>

IFRSs and strict application of an operating capability concept of wealth

C5 Based on the above Table, it is evident that, for various classes of assets and liabilities, IFRSs involve highly similar measurement treatments to those under a strict application of an operating capability concept of wealth. For example:

⁷⁸ A liability-specific risk adjustment would generally be incorporated in estimated cash flows. This contrasts with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which incorporates liability-specific risk in the discount rate.

- (a) the measurement of impairments of assets within the scope of IAS 36 *Impairment of Assets* is highly similar under both ‘regimes’;
- (b) current market entry price is the same or highly similar to fair value for all financial assets and liabilities, and many non-financial assets and liabilities (including assets, such as certain commodities, that are bought and sold in the same market), measured at fair value under IFRSs (either initially or subsequently). For example:
 - (i) for various non-financial assets (including specialised assets), the cost approach in IFRS 13 *Fair Value Measurement* (which uses a current market entry price) would be used to estimate fair value; and
 - (ii) the market approach used to estimate the fair value of some assets under IFRS 13 would result in a highly similar measure to current market entry price, e.g. in the case of land and many investment properties; and
- (c) the measurement requirements for provisions in IFRSs, and the proposals in IASB ED/2013/7 *Insurance Contracts* for measuring insurance contract liabilities, are highly consistent with a strict application of an operating capability concept of wealth (including the use of fulfilment values based on entity-specific cash flows—in contrast to the proposals in IASB ED/2010/1 *Measurement of Liabilities in IAS 37* to take into account the cash flows other market participants would demand to fulfil the obligations).

Possible modifications of the ‘operating capability’ concept of wealth

- C6 A possible standards-level modification of strict application of the ‘operating capability’ concept of wealth that would achieve consistency with current IFRSs is providing an option to apply the cost model or revaluation model to property, plant and equipment, intangible assets and investment properties. Over time, ideally, that option would not be retained. At this time, however, and in the context of revising the IASB Conceptual Framework, the AASB regards the more important consideration to be signposting possible future evolution in measurement based on a coherent concept of wealth.
- C7 The above Table identifies that remeasurements could also be optional for assets and liabilities expected to be disposed of, or settled, respectively, in the short run. This would help minimise changes to current IFRS without, in most cases, omitting to recognise important changes in the operating capability embodied within assets and liabilities.

Conclusion

- C8 Based on the discussion in this Appendix, the AASB considers that an ‘operating capability’ concept of wealth could be modified in a manner that is broadly consistent with present IFRSs. Identifying an ideal concept of wealth (in the AASB’s view, operating capability) would provide a conceptual starting point and

discipline for identifying how measurement treatments in IFRS might be amended over time, through due process.

APPENDIX D

The AASB's comments on process issues relating to the DP, and other aspects

Subsequent review and update of the IASB Conceptual Framework

- D1 The AASB recommends that the IASB should regard its Conceptual Framework as a living document, and thus should commit to reviewing and updating it from time to time in light of subsequent developments in financial reporting. The timing of such reviews should reflect the IASB's resources and priorities, and developments in conceptual thinking. Just as the IASB's current review of the Conceptual Framework was occasioned, in part, by developments in the IASB's thinking on conceptual issues, so is it likely that such developments will continue to occur. This approach would be beneficial, for example, in respect of concepts for the unit of account and the role of the business model. Under circumstances such as these, it is important not to treat the IASB Conceptual Framework as an immutable document. However, this does not mean it is unnecessary to fill the conceptual gaps of which the IASB is presently aware and capable of addressing within a reasonable timeframe (see the comments on this aspect in paragraph 9 of this submission).

Sector-neutral expression

- D2 The AASB encourages the IASB to use sector-neutral expression in the revised Conceptual Framework wherever possible, to help facilitate the development at some point of a common Conceptual Framework for reporting entities in all sectors of the economy, whether for-profit or not-for-profit in nature. Although their ultimate objectives differ, for-profit entities and not-for-profit entities both provide goods and services to external parties and use economic resources in the process; obtain these resources from external sources and are accountable to the providers of the resources or their representatives; control stocks of economic resources; incur present obligations; and must be financially viable to meet their objectives. See also the comments below regarding liaison with the IPSASB regarding the Boards' respective Conceptual Framework projects.
- D3 In addition, government business enterprises [GBEs] (which generally are for-profit entities) adopt IFRSs and the IASB Conceptual Framework in various jurisdictions, consistent with the view of the International Federation of Accountants that they should do so (instead of adopting International Public Sector Accounting Standards and the forthcoming IPSASB Conceptual Framework). Adopting sector-neutral expression in the revised IASB Conceptual Framework would also assist GBEs to apply that policy.

Relationship between the IASB and IPSASB Conceptual Framework projects

- D4 The AASB recommends that the IASB maximises its liaison with the IPSASB regarding the Boards' respective Conceptual Framework projects, in the context of the Memorandum of Understanding between the IASB and the International

Federation of Accountants dated 22 November 2011. Australia's experience with addressing conceptual issues has been that constituents from both the private and public sectors have raised issues that benefit each other's sector.

- D5 Ideally, the IASB and IPSASB Conceptual Frameworks would be complementary, where the only differences are those warranted by differences in circumstances between sectors. This would support the development of International Financial Reporting Standards and International Public Sector Accounting Standards that differ only where necessary to deal with different economic phenomena. This approach is also likely to assist users of general purpose financial reports who read financial reports across all sectors in the economy (e.g. rating agencies), which is important given the fundamental objective of general purpose financial reporting to meet users' information needs. It should be borne in mind that because the IPSASB's remit is public sector entities, the IPSASB Conceptual Framework might not address issues pertinent to private sector not-for-profit entities. If the IASB's and IPSASB's Conceptual Frameworks were complementary, this 'coverage' issue should be less of a problem.
- D6 The AASB's arguments in relation to the IASB DP in this submission are mainly focused on technical issues, and not primarily on whether the IASB's preliminary views are consistent with the thinking of the IPSASB in its Conceptual Framework project.