Summarised feedback from Conceptual Framework Discussion Forums on AASB ED 264 *Conceptual Framework for Financial Reporting* and ED 265 *Updating References to the Conceptual Framework*

Melbourne and Sydney
August 2015

Overall comments

1 Participants generally concurred that:

(a) various aspects addressed in the Exposure Drafts were not concepts but rather a collection of statements;

(b) more clarity around the proposals and more guidance is necessary.

Stewardship and Prudence (IASB ED/2015/3 Questions 1(a) and 1(b))

Prudence

2 Participants generally did not consider that the reintroduction of the term 'prudence', in the manner proposed, added significant value to the Conceptual Framework and expressed mixed views as to whether 'prudence' should be reintroduced at all. Almost all participants did not want 'asymmetric prudence' introduced for the reasons outlined in the Basis for Conclusions.

3 Some participants also noted:

(a) prudence is a difficult concept to convey, as it may be interpreted differently by different people, for example, by management versus prudential regulators;

(b) disagreement with the IASB's rationale for reintroducing the term prudence as they did not consider that the absence of the term from the conceptual framework should be interpreted as the IASB setting standards that were imprudent;

(c) the associated 'baggage' with the term 'prudence';

(d) prudence should not be reintroduced because the IASB's discussion about the manner in which prudence applies is insufficient to overcome the historical usage of the term within standard-setting and academia, particularly since prudence has historically been discussed within the context of the doctrine of conservatism;

(e) prudence is applied differently from 'cautious prudence' by prudential regulators (who may also be the financial regulator), and commented that the term prudence is used within the Basel framework;

(f) prudential regulators would probably prefer to start with neutral information and build in their own level of prudence – if the information has already been affected by some unknown level of prudence, that would make their work more difficult;

(g) generally, participants agreed with prudence being described as 'cautious prudence'. However, other participants observed that while users such as investors would support the reintroduction of 'prudence', they much preferred an interpretation of 'asymmetric prudence' (rejected by the IASB) rather than 'cautious prudence';

(h) there does not seem to have been an impact on standard setting by having prudence removed from the conceptual framework;

(i) the application of prudence could be approached as a basis for the IASB's determination of an appropriate accounting policy (e.g. IFRS 9 *Financial Instruments* expected loss impairment model) or for application by those using IFRS when preparing financial statements, particularly in measuring financial information. If the IASB intends for prudence to be considered in only one of these situations, this needs to be clarified in the proposals;

(j) although some might consider the new expected loss model in IFRS 9 to be based on prudence, it is really just forward-looking – you do not need prudence to get that model;

(j) there are generational differences in how people interpret 'prudence', which means it could give rise to information that lacks comparability; and

(k) if the problem is perceived to be management bias towards optimism, it is best dealt with as part of 'neutrality' which is in the Conceptual Framework to counter optimism (and pessimism).

4 Participants suggested alternative approaches to reintroducing the term:

(a) selection of a different word (e.g. 'balance'); and/or

(b) conveying the notions of caution and carefulness within neutrality; and/or

(c) expanding the discussion on neutrality to note the absence of management bias.

A participant noted that the relationship between prudence, materiality and relevance should be clearly explained in the Conceptual Framework.

<u>Stewardship</u>

5 There was general support for the proposal to give more prominence to stewardship. Various participants noted the importance of stewardship to a broader group of users. However, some participants expressed disagreement with the reintroduction of the term itself, noting that there did not seem to be much gained by its reintroduction.

6 Some participants also noted:

(a) if stewardship is reintroduced, the term needs to be better explained; for example, is stewardship merely accountability (?);

(b) stewardship is neutral; it does not reveal how well management has performed;

(c) the Conceptual Framework should better clarify how management stewardship may be reflected in financial information presented (for example, in related party disclosures or liquidity analysis disclosures);

(d) stewardship's contribution both to the prospects for future cash flows (forward-looking) and how efficiently and effectively management had used the entity's resources (backward-looking) should be better described in the Conceptual Framework;

(e) a focus on stewardship may result in entities defaulting to historical cost as a preferred measurement basis, and that stewardship has been historically contrasted with decision usefulness;

(f) stewardship could be regarded as implying a need for current value measurement because a lack of value creation might reflect poor stewardship; and

(g) the guidance on stewardship needs to better explain the role of stewardship in decision-usefulness, rather than as a driver of the measurement basis – the latter is the manner in which the role of stewardship has historically been regarded (but also the understanding is changing).

Relevance and measurement uncertainty (IASB ED/2015/3 Question 1(d))

7 Participants generally agreed:

(a) with the proposal not to reintroduce 'reliability' as a concept into the Conceptual Framework;

(b) that guidance on measurement uncertainty within the Conceptual Framework is necessary.

8 Participants agreed that measurement uncertainty is one factor that can make financial information less relevant; however, some commented that they would not want the discussion on measurement uncertainty to imply that the conclusion is that information with greater measurement uncertainty (for example, some provisions) is not relevant, and accordingly, need not be measured (whether as a recognised element, or disclosed).

9 Participants expressed mixed views as to whether measurement uncertainty should be described as affecting relevance, or as affecting faithful representation. Some participants also noted:

(a) measurement uncertainty is not necessarily a conceptual matter, but the manner in which it is currently incorporated in the proposals is acceptable;

(b) measurement uncertainty may be used as the test between recognition or (solely) disclosure, but the proposals do not include sufficient guidance in this regard;

(c) the discussion of measurement uncertainty seems designed to set up for the later chapter (Chapter 5) that promotes a mixed measurement regime;

(d) ‘outcome uncertainty’ and measurement uncertainty are different things, and it could be that the existence of an item is reliably determinable but its measurement uncertain;

(e) the issue of director liability if entities got the decision ‘wrong’, as relevance is subjective; and

(f) various IFRSs currently refer to ‘reliably measured’ or ‘reliable measurement’, and the IASB should consider amending such references in a timely manner to ensure that the terminology is updated consistent with these proposals.

Present obligation and ‘no practical ability to avoid’ (IASB ED/2015/3 Question 4)

10 Participants expressed concerns about the implications of the proposed amendments to the definition of a present obligation, which seem designed to solve concerns about issues addressed in IFRIC 21 *Levies*. Many participants considered that the proposed amendments are likely to create more issues (for example, issues currently addressed in IAS 32 *Financial Instruments: Presentation* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) than they solve. Participants understood that the IASB would separately address how the new conceptual framework might affect an individual IFRS; but noted it would be disingenuous to use the new framework to target particular issues (such as accounting for levies) and ignore the other consequences. Some participants commented that the Conceptual Framework needs to be persuasive, but not try to solve all standards-level considerations. Participants agreed that at a standards-level, the IASB could make different decisions as to whether a liability exists (whether the definition should be broadened/narrowed) to the definition included in the Conceptual Framework.

11 Some participants noted that the consequences, intended or otherwise, of the proposals beyond how they applied to certain bank levies needed to be considered by the IASB before it finalises its proposals in this regard, including how the proposals apply to liabilities that are built up over time (e.g. long service leave). Others were concerned at the interaction between the proposal to amend the definition of a liability and the work being conducted as part of the Financial Instruments with Characteristics of Equity project.

12 Some participants also noted:

(a) ‘no practical ability to avoid’ the transfer would be no easier to interpret in practice than economic compulsion;

(b) guidance will be necessary to assist with identifying the relevant past event in a series of events, and with distinguishing between commitments and obligations;

(c) financial instruments are likely to be restructured following any amendments to the definition to continue to achieve a particular desired accounting outcome;

(d) financial markets and regulators may continue to make their own classification of financial instruments separately from the outcome from the accounting classification;

(e) it is not clear which perspective will apply in deciding the practical ability to avoid; for example, shareholders, management and directors may have different perspectives on whether an entity has the practical ability to avoid making a transfer of dividends or with respect to provisions for remediation – this needs to be clearly expressed, whether at a Conceptual Framework level or at a standards-level;

(f) the assessment of ‘no practical ability to avoid’ is a standards-level issue, not a conceptual framework issue;

(g) ‘no practical ability to avoid’ probably fits with a ‘going concern’ notion; and

(h) if there is no recognition of a liability when the entity has the practical ability to avoid the transfer, how might the definition apply when an entity could avoid part of an obligation, but not the entire transfer (?).

13 One participant noted that the proposed explanation of ‘past event’, which could be regarded as expanding on what is in the existing *Framework,* might be sufficient to address the levies issue.

Recognition criteria – low probability and measurement uncertainty (IASB ED/2015/3 Question 6)

14 Participants noted:

(a) ‘low probability’ is subjective and open to interpretation;

(b) the proposals would not resolve the debate around whether a remediation provision should be recognised;

(c) there is a risk that the proposals would mean derivatives with low probability of future cash flows are not recognised, and yet they should be;

(d) the Conceptual Framework should clarify that the indicators for recognition should not be considered in isolation, but may need to be traded-off against one another;

(e) the Conceptual Framework should clarify that the cost-benefit consideration to recognition is a standards-setting decision, not a preparer decision;

(f) goodwill may not meet the criteria, which could open up new arguments about accounting for it;

(g) the current recognition criteria are not broken – so they do not need to be fixed;

(h) there should only be a recognition section, with the presumption that derecognition is the reverse – so the proposed derecognition section of the Conceptual Framework is redundant; and

(i) it is not clear how the recognition criteria would apply in practice to liabilities and expenses.

Factors to consider when selecting a measurement basis (IASB ED/2015/3 Question 9)

15 Participants expressed mixed views about Chapter 5. Some participants observed that the chapter is not conceptually sound, but understood that the drafting needed to cater for strongly held differences in views globally on measurement. Some participants considered that the Conceptual Framework should aspire towards current values (even if other decisions were made about measurement at a standards-level); others favoured the mixed attributes model discussed in the proposals. Some participants noted that it was important for the IASB to be clear as to what financial position and financial performance should represent before addressing measurement.

16 Some participants also noted:

(a) the measurement chapter seems to be explaining a system of accounting, rather than a set of concepts;

(b) the Conceptual Framework needs to be more than an explanation of the status quo – otherwise we will never make any progress on measurement – it would be better to focus on defining ‘financial performance’ and ‘financial position’;

(c) the use of a business model in driving the selection of a measurement basis is to be encouraged;

(d) the use of business models is subject to management, and could be manipulated to drive the choice of measurement, or may be outdated;

(e) the use of business models as a driver of measurement might provide more opportunities for fair value measurement;

(f) the relationship between stewardship and the measurement basis – with mixed views being expressed on whether stewardship might be best shown through historical costs (probably the ‘traditional’ view) or current values (based on the view that management stewardship might relate to ensuring maintenance or enhancement of value);

(g) the relationship between capital maintenance and the measurement basis;

(h) a mixed measurement approach should not be contemplated in the Conceptual Framework because it results in a meaningless balance sheet;

(i) historical costs or the use of mixed measurements give rise to meaningless metrics, such as ‘return on equity’;

(j) ‘relevance’ may drive some to selecting a current value as a measurement basis;

(k) the focus should be on whether the volatility that comes with fair valuing is informative in a particular case; and, if it is not, historical cost would be the more appropriate measurement basis;

(l) the discussion on ‘measurement uncertainty’ seems designed to set the scene for a mixed measurement approach; and

(m) the ‘mistrust’ of current values embedded in IFRSs has given rise to major problems with unrecognised (and/or undisclosed) intangible assets – it is a key gap in the usefulness of financial information for many types of entities.

Presentation and disclosure: Definition of profit or loss, use of other comprehensive income (OCI), and recycling (IASB ED/2015/3 Questions 12, 13 and 14)

17 Participants expressed mixed views as to whether profit or loss was the key indicator of performance or whether total comprehensive income was more important. There was general agreement that OCI on its own is meaningless. Many participants noted that the IASB needs to define profit before making decisions on the use of OCI; others considered that OCI, rather than profit, should be defined. Participants generally agreed that, in a framework that draws a distinction between profit or loss and OCI, it was a major inadequacy for those terms not to be defined.

18 Participants generally agreed that, at a standards-level, the use of OCI is being extended too far. Participants generally agreed that they would want the use of OCI to be kept fairly restricted. There was discussion about the link between the increasing use of mixed measurement approaches in IFRSs – fair value in the balance sheet and a form of historical cost in the income statement, and the perpetuation of the use of OCI.

19 Some participants also noted:

(a) investors are interested in all of profit, and cash flows, and the balance sheet;

(b) the profit or loss versus OCI distinction should not be included in a Conceptual Framework, which should instead consider presentation at a more principled level – the distinction is a standard-setting matter, and embedding it in a Conceptual Framework simply perpetuates existing thinking on presentation;

(c) given that market participants do not consider OCI to be important, the IASB needs to be careful about what goes into it;

(d) Chapter 7 needs to better link to the qualitative characteristics of useful financial information; and

(e) Chapter 7 would be improved if it discussed the different dimensions of performance to different users: for example, that some are interested in realisation, some in capital maintenance and others in cash flows.

20 Participants expressed mixed views as to the extent to which they supported the recycling of amounts from OCI into profit or loss; however, there was very little support for 100% recycling. Participants noted:

(a) support for the use of OCI to separately distinguish capital streams from revenue streams, or unrealised from realised gains and losses. Some participants did not support recycling in all these instances;

(b) the useability of profit or loss suffers when items are recycled, as the profit or loss is then a combination of performance relating to events of the period and recycled amounts;

(c) there should be no need for OCI (and accordingly, recycling) because all items should be recognised in a single statement of financial performance; and

(d) volatility in profit is not necessarily to be avoided and, with appropriate labelling (e.g. 'unrealised gains'), analysts and other users may adjust 'profit' as appropriate for their purposes.

Other matters raised

21 *Role of general purpose financial statements:* A participant noted the role of financial statements for financial reporting purposes, and cautioned against developing proposals reflective of a shift to emphasising forward-looking corporate reporting. They noted that a key value of reporting on the situation at balance date and the performance for the period just passed is that it provide a common benchmark that can be used by investors and other users in conjunction with other information.

22 *Primary users:* A participant commented that general purpose financial statements (GPFS) should serve the needs of an extended set of users, including investors, lenders and creditors, as well as other users with a 'right to know', such as employee unions.

23 *Knowledge of users:* Some participants commented on the level of user knowledge required to understand the development of IFRSs and the content of GPFS. It was noted that the IASB needs to have in mind at least some level of knowledge as the basis for setting IFRSs, but that the level of knowledge may have been set too high. There were differing views on the level at which IFRSs and the resulting GPFS should be pitched. It was noted that it is not the role of the IASB to address the level of financial literacy – and the role of education is crucial to there being knowledgeable preparers and users.

24 *Reporting entity:* Some participants noted that the descriptions of 'direct control' and 'indirect control' in Chapter 3 are confusing, given the manner in which control is used in existing IFRSs. Other participants cautioned that the IASB should be careful not to cause problems in Chapter 3 with less conventional entity relationships; for example, stapled entities or IPO information.

APPENDIX: ABOUT THE DISCUSSION FORUMS

Agenda

The agenda for the Discussion Forums held in Melbourne (10 August) and Sydney (11 August) was as follows:

Item	Topic
1	Welcome and Introduction
2	Stewardship and Prudence [IASB/ED/2015/3 Questions 1(a) and 1(b)]
3	Relevance and measurement uncertainty [IASB/ED/2015/3 Question 1(d)]
4	Present obligation and 'no practical ability to avoid' [IASB/ED/2015/3 Question 4]
5	Recognition criteria – low probability and measurement uncertainty [IASB/ED/2015/3 Question 6]
6	Factors to consider when selecting a measurement basis [IASB/ED/2015/3 Question 9]
7	Presentation and disclosure • definition of profit or loss [IASB/ED/2015/3 Question 12] • use of other comprehensive income [IASB/ED/2015/3 Question 13] • rebuttable presumption on recycling [IASB/ED/2015/3 Question 14]
8	Other matters that participants would like to raise on ED 264 or ED 265
9	Concluding remarks

Attendees

Participants and observers were from:

- Academia (7)
- Corporate preparers (4)
- Public sector preparers (5)
- Investor users (1)
- Regulatory bodies (2)
- Audit firms (13)
- Accounting consultants (4)
- Professional accounting bodies (3)
- Standard-setting bodies (2)

The following AASB Board members were present at one or both of the Discussions Forums held in Melbourne and Sydney:

- Kris Peach, Chair
- Regina Fikkers
- Megan Wilson
- Anna Crawford
- Marc Smit
- Andrew Kearnan