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Mr Kevin Stevenson,
Chairman & CEO,
Australian Accounting Standards Board,
PO Box 204,
Collins Street West,
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via e:mail to standard@aasb.gov.au

Dear Kevin,

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

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

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

1. Definition of liability

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

2. Obligation to issue shares

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

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

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

3. Puttable Instruments

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

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

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

4. Statement of Comprehensive Income

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

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

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

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

5. Subsequent Measurement Basis

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

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

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

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

Thank you for the opportunity to contribute.

Yours sincerely,

Andrew Porter
Chief Financial Officer