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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 resources[2].

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

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[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 flows[3].

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

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[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).

(b) their economic significance, individually and collectively, is capable of being understood.[4]

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 borrowings[6];

(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:

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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 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.

(i) recognised assets are generally measured at the amounts the entity would currently need to pay to acquire them; and

(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 transaction[7] 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 flows[8]. 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;

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.

(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

(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 flows[10] (see the elaboration of this comment in paragraph B90 of Appendix B below).

<u>Section 7—Presentation and disclosure</u>

20 The AASB considers this largely descriptive section of the DP would be unlikely to satisfy the needs of users of financial reports for a meaningful disclosure and presentation framework. Nor does it seem sufficient to help the IASB decide how to streamline excessive disclosures and make information more relevant. The AASB considers that, instead of documenting the accounting constructs currently employed, it is important to explain the ways to determine disclosures that more directly and efficiently link with the objective of financial reporting.

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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.

21 The AASB considers there is a gap in the Conceptual Framework, between the objective level and the lower levels, that should be filled by identifying the generic types of information about an entity that are relevant to users in order for them to make decisions about the allocation of scarce resources. Filling that gap is necessary if the Conceptual Framework is to provide a sound conceptual basis for developing better targeted presentation and disclosures that help meet the common information needs of users.

22 The AASB acknowledges that paragraphs 7.7 – 7.8 of the DP indicate Section 7 deals with only some aspects of disclosure, in light of the IASB's intention to conduct other work on disclosure, including a review of IAS 1 *Presentation of Financial Statements*, IAS 7 *Statement of Cash Flows* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, until that other work is more substantially progressed, it is difficult to gain an overview of the principles that might complement Section 7 of the DP.

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).

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 resources[11]. 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 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

[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.

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@aasb.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* <u>vision of ideal financial reporting</u> 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 present[12]. 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 claim[14] [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 flows[15]).

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 prepare[16], 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 model[17]) 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 model[18] 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 understood[19]. 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:

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[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 assessments[22] 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, Barth[23] 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 Tape[24], Barth, Landsman and Wahlen[25] 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 Harris[26] 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 Kasznik[27]:

    (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

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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 Clinch[28] found that revalued investments[29], intangible assets and property, plant and equipment[30] 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.

Section 7—Presentation and disclosure

A39 The stated purpose of Section 7 of the DP is to identify principles that underlie decision-making by the IASB regarding presentation and disclosure. However, the AASB considers that the section is more of a catalogue of existing requirements of IFRSs and recent IASB thinking. For example, whilst paragraph 7.26 of the DP says the IASB believes classification and aggregation into line items and subtotals should be based on similar properties, such as an item's function or nature, or how it is measured, the reasons for identifying these bases for classification and aggregation (and reasons for not identifying other bases) are not provided.

A40 Accordingly, the AASB considers this largely descriptive section would be unlikely to satisfy the demands of users of financial reports for a meaningful disclosure and presentation framework. Nor does it seem sufficient to help the IASB decide how to streamline excessive disclosures and make information more relevant. The AASB considers that, instead of documenting the accounting constructs currently employed, it is important to explain the ways to determine disclosures that more directly and efficiently link with the objective of financial reporting.

A41 Paragraph OB8 of the IASB Conceptual Framework mentions that the IASB, in developing standards, focuses on the common information needs of the identified primary[31] users of financial reports. The AASB considers that, despite this comment in paragraph OB8 of the Conceptual Framework, the ramifications of focusing on the common information needs of users have not been sufficiently explored in the DP generally. In particular, the ramifications of focusing on the common information needs of users have not been explored in relation to presentation and disclosure.

A42 An example of how common information needs of users could be used to better focus presentation and disclosure requirements is given in AASB Essay 2013-1 *Rethinking the Path from an Objective of Economic Decision Making to a*

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[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.

[31] A reference to 'primary users' is implicit in each reference to 'users' in this submission.

Disclosure and Presentation Framework (August 2013). That essay contends there is a gap in the Conceptual Framework between the objective level and the lower levels, which should be filled by identifying the generic types of information about an entity that are relevant to users for making decisions about the allocation of scarce resources. The essay identifies the stocks and flows that are potentially relevant to users of financial reports of all entities and might fill that gap. It contends that, among other consequences, purpose-driven (rather than topic-driven[32]) disclosure and presentational approaches could flow from attempts to faithfully represent those stocks and flows, resulting in a substantial rationalisation of existing disclosures and a way of resolving debates about presentation.

A43 Whilst the AASB does not argue that the stocks and flows identified in AASB Essay 2013-1 necessarily represent the only set of generic information types on which to base presentation and disclosures, the AASB does consider it necessary for the above-mentioned gap in the Conceptual Framework to be filled if the Conceptual Framework is to provide a sound conceptual basis for developing better targeted presentation and disclosures that help:

(a) meet the common information needs of users; and

(b) respond to users' needs regarding how that information is classified and aggregated.

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

[32] Examples of topic-driven disclosures are disclosures developed separately in relation to leases and revenue. Some lease contracts and contracts with customers giving rise to revenue have similar characteristics; arguably, a common core set of purpose-driven disclosures would be appropriate for both types of contracts.

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 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 loss[33] (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.

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)[34]]
>
> "Recognising an item of income or expense in OCI will enhance the relevance of profit or loss if that:

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33 Termed 'profit' in the existing Framework.

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

(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."[35] (paragraph 8.46)

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 disclosure[36]). 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 value[37]. 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

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35 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 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.

36 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.

37 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.

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.

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 flows[38]. 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][39];

(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

[38] 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.

[39] 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.

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 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 losses[40], 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)[41]] 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 remeasurements[42]. The AASB would not agree with such a characterisation of 'realised income and

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

[41] 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.

[42] 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.

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 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 provision[43], the policy in Approach 2B that a current period remeasurement could[44] 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 time[45]. 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

[43] 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.

[44] i.e. subject to meeting the 'enhanced relevance' test in paragraph 8.88(c) of the DP.

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

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[46].[47] 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 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

[46] 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.

[47] 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.

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 particular[48], 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 report[49]. 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 OCI[50].

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

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48 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.

49 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.

50 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.

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.

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 2A[51]) 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

[51] 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.

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: "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

Section 1—Introduction

Purpose of the Conceptual Framework

B1 The AASB is concerned with the statements in paragraph 1.26 of the DP that:

> "… the primary purpose of the revised *Conceptual Framework* is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs. The IASB believes that focusing on the needs of the IASB when setting Standards will help to provide better targeted concepts for the revised *Conceptual Framework*."

B2 The AASB acknowledges that paragraph 1.27 of the DP says the Conceptual Framework plays an important role in helping other parties to understand and interpret IFRSs and to develop accounting policies when no IFRS specifically applies to a particular transaction or event. However, the AASB is concerned that giving undue emphasis to assisting the IASB in standards-level projects would create a risk that helping these other parties would be given insufficient attention in the IASB's decision making about the Conceptual Framework.

B3 In particular, the AASB is concerned that giving primacy to assisting the IASB in standards-level projects might create a risk that the IASB Conceptual Framework is viewed essentially as a problem-solving resource (or toolkit for standards-level projects) for the IASB. The statement in paragraph 1.32 of the DP that there may be **rare** cases in which the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework exposes the Conceptual Framework to that risk. That is, if conflicts between IFRSs and the Conceptual Framework were pre-ordained to occur only rarely, this could lead to the IASB (and its constituents) "peeking ahead" to identify treatments that would be compatible with existing or anticipated IFRSs, rather than focusing on economic phenomena, when developing the revised IASB Conceptual Framework and subsequent updates thereof (and commenting on proposals in relation thereto).

B4 Consistent with its comments in paragraphs A11 – A14 of Appendix A above, the AASB considers it vitally important that the IASB Conceptual Framework describes the economic phenomena that affect reporting entities and are relevant to the users of general purpose financial reports, regardless of whether those economic phenomena are within the scope of particular IFRSs, and regardless of whether and how those economic phenomena are accounted for under IFRSs. Describing the economic phenomena that affect reporting entities and are relevant to the users of general purpose financial reports is important because it:

(a) identifies for the IASB and its constituents the conceptual underpinnings of financial reporting;

(b) should maximise the likelihood that the concepts will be sufficiently robust to cover all transactions and other events that the IASB and its constituents may need to consider; and

(c) should minimise the risk that the Conceptual Framework "peeks ahead" to acceptable and practical treatments in IFRSs and omits, in some cases, to identify the most relevant and representationally faithful information about economic phenomena (which, ideally, should be reported, even if it is concluded in standards-level projects that IFRSs should not fully require that information to be reported, perhaps for pragmatic reasons).

B5 Economic phenomena exist independently of those who describe them. Similarly, a Conceptual Framework focused on economic phenomena should not be regarded as belonging to any particular party. Accounting responses to economic phenomena can justly be described as belonging to a standard setter; however, accounting responses would seem to belong mainly at a standards level.

B6 The AASB is concerned that identifying the primary purpose of the revised *Conceptual Framework* as being to assist the IASB in standards-level projects might lead to omitting issues from the IASB Conceptual Framework on which IFRSs are not intended to be developed. Such an outcome could lead to the problem that guidance, whether conceptual or otherwise, would not be developed for issues on which there is neither an applicable requirement of an IFRS nor a requirement of an IFRS on a similar or related issue. An example of where this would be a potential problem for preparers and auditors is the preliminary views that, in effect, no recognition criteria should be contained in the Conceptual Framework but the IASB might incorporate in particular IFRSs similar recognition criteria to the 'probable future economic benefit' and 'reliable measurement' criteria in paragraph 4.38 of the existing IASB Conceptual Framework[52]. For transactions

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[52] This comment is based on the following preliminary views in the DP:
"an entity should recognise all its assets and liabilities, except as discussed in paragraphs 4.25–4.26. …" (paragraph 4.24);
"the *Conceptual Framework* should state that the IASB might decide in developing or revising particular IFRSs that an entity need not, or should not, recognise an asset or a liability:
(a) if recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or not sufficiently relevant to justify the cost; or
(b) if no measure of the asset (or the liability) would result in a faithful representation of the asset (or the liability) and of changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed." (paragraph 4.25); and
"The Conceptual Framework could provide further guidance to help the IASB to assess when recognising an asset or a liability might not provide relevant information. For example, such guidance could suggest that the following are some indicators that recognition might not provide relevant information:
(a) if the range of possible outcomes is extremely wide and the likelihood of each outcome is exceptionally difficult to estimate … in some cases, trying to capture that information in a single number as a measure for recognition in the statement of financial position may not provide any further relevant information.
(b) if an asset (or a liability) exists, but there is only a low probability that an inflow (or outflow) of economic benefits will result … the IASB might conclude that users of financial statements would be unlikely to include information about that inflow (or outflow) directly in their analysis. …" (paragraph 4.26).

and other events that are outside the scope of those particular IFRSs (and do not arise in respect of an issue that is similar or related to issues within those IFRSs), entities would be unable to apply those recognition criteria (i.e. they would be required to recognise all of the assets and liabilities that arise from the transaction or other event). Consequently, different recognition criteria would apply to different elements of financial statements.

B7 The AASB thinks it is important not to assume that virtually all significant transactions and other significant events will be subject to an applicable requirement of an IFRS or a requirement of an IFRS on a similar or related issue. In addition, new types of transactions (e.g. new types of contractual promises) may arise; an advantage of a robust Conceptual Framework is that it would cater for such developments.

B8 The AASB considers that a solution to any concerns that the IASB Conceptual Framework might become too broad in its coverage of issues would be to develop further the notion in the IASB Conceptual Framework that general purpose financial reporting focuses on meeting the *common information needs* of users of general purpose financial reports. Paragraph OB8 of the IASB Conceptual Framework refers to financial reporting standards being focused on common information needs. However, it is not apparent how focusing on common information needs of users has been reflected in the specific concepts either contained in the existing IASB Conceptual Framework or proposed in the DP. For example:

(a) the AASB considers that the preliminary view that 'transfers of wealth' between different classes of equity claims should be recognised when no changes in the entity's assets or liabilities have occurred (as discussed in paragraphs 5.12 – 5.13 of the DP) would be incompatible with meeting the common information needs of users (see paragraph B62 below); and

(b) the AASB observes that Section 7 of the DP does not indicate how focusing on common information needs might help the IASB to rationalise disclosures in IFRSs (see paragraph A41 above).

B9 For these reasons, the AASB recommends that the IASB gives due regard to the Conceptual Framework's dual roles in:

(a) assisting the IASB by identifying concepts that it will use consistently when developing and revising IFRSs (as per the preliminary view in Question 1(a) of the DP); and

(b) helping other parties to understand and interpret IFRSs and to develop accounting policies when no IFRS specifically applies to a particular transaction or other event.

Relationship between the IASB Conceptual Framework and IAS 8

B10 The AASB recommends the IASB considers how to better describe the relationship between its Conceptual Framework and the requirement in paragraph 11(b) of IAS 8 that, in the absence of an IFRS that specifically applies to a transaction, other event

or condition, management, in using its judgement in developing an appropriate accounting policy, shall refer to, and consider the applicability of the definitions, recognition criteria and measurement concepts in the Framework[53]. The AASB strongly supports retaining the general principle in paragraph 11(b) of IAS 8. However, to complement that principle, the AASB considers that the IASB Conceptual Framework should also explicitly acknowledge its role in providing a pathway to improved financial reporting. Otherwise, the following problems might arise:

(a) applying paragraph 11(b) of IAS 8 might require entities to consider concepts the application of which requires future standards-level guidance and/or would presently give rise to costs that exceed the related benefits; or

(b) for similar reasons to those set out in paragraph B3 above (in respect of the presumed rarity of conflicts between IFRSs and the IASB Conceptual Framework), the IASB might "peek ahead" to identify treatments that would be compatible with existing or anticipated IFRSs, rather than focusing on economic phenomena, when developing concepts.

B11 Therefore, the AASB considers that (whilst the IASB Conceptual Framework should set out what the IASB considers to be the ideal principles for each topic it addresses) the IASB Conceptual Framework should explicitly distinguish:

(a) concepts that should presently be considered when applying paragraph 11(b) of IAS 8; from

(b) concepts that signal a pathway to future best practice. These concepts would need to be overtly aspirational.

B12 The limitation referred to in paragraph B11(a) above would not apply to the IASB when developing or revising IFRSs.

B13 An example of paragraph B11 above is that the revised IASB Conceptual Framework could say that:

(a) ideally, a particular concept of wealth should be applied when defining and measuring assets and liabilities; but

(b) standards supporting that principle will take time to develop, and, accordingly, entities are not required to adopt that concept of wealth when applying paragraph 11(b) of IAS 8.

B14 The AASB's recommendation in paragraph B11 above would not entail a weakening of the AASB's view (expressed in paragraph A11 above) that the IASB Conceptual Framework should focus only on economic phenomena affecting an entity. Adopting that recommendation could lead to some economic phenomena not being fully accounted for by entities referring to the IASB Conceptual Framework

[53] Regard would be had to these concepts after considering the requirements in IFRSs dealing with similar and related issues (paragraph 11(a) of IAS 8).

or to less than ideal information about economic phenomena being reported for the time being, but would not provide conceptual justification for reporting items that are not economic phenomena. In addition, the AASB considers that the range of concepts to which paragraph B11(b) above might apply [and presently would not need to be considered when applying paragraph 11(b) of IAS 8] should be relatively limited and, in most cases, temporary.

B15 The AASB acknowledges that this issue is standards-level in nature, as it is unrelated to enunciating concepts for financial information about economic phenomena that is most useful for meeting the 'resource allocation decisions' objective of financial reporting. However, the AASB considers it would probably be more practical to make the distinction described in paragraph B11 above in the revised IASB Conceptual Framework. This is because:

(a) paragraph 11(b) of IAS 8 is confined to a cross-reference to the IASB Conceptual Framework; including in IAS 8 concepts that presently need not be considered would change the structure of that Standard; and

(b) describing in IAS 8 the concepts referred to in (a) immediately above would be likely to require additional material to place those concepts in context, which would be inefficient.

B16 The AASB considers that the need for this explicit clarification of the dual roles of the IASB Conceptual Framework (referred to in paragraph B10 above) would be significantly greater when that Framework is revised than at present, because the DP foreshadows that the revised IASB Conceptual Framework will include guidance on topics not covered by the existing IASB Conceptual Framework (e.g. concepts for derecognition of assets and liabilities, and presentation and disclosure) and will include normative guidance on a broad topic in respect of which the existing IASB Conceptual Framework includes only descriptive guidance (i.e. measurement concepts).

B17 After the IASB fills in significant gaps in its Conceptual Framework (e.g. concepts for derecognition, and presentation and disclosure), the AASB considers that, logically, paragraph 11(b) of IAS 8 should refer to any aspects of that Framework, and not be limited only to those aspects of that Framework dealing with definitions, recognition criteria and measurement concepts for the elements of financial statements. Broadening the scope of that cross-reference from IAS 8 to the IASB Conceptual Framework would accentuate the importance of clarifying the dual roles of the Conceptual Framework along the lines set out in paragraph B11 above.

Section 2—Elements of financial statements

Reference to probability in the recognition criteria

B18 The AASB disagrees with the preliminary view in paragraph 2.35(c) of the DP that the reference to probability should be deleted from the recognition criteria, for the reasons discussed in paragraphs B19 – B34 below.

‘Ideal approach to recognition’

B19 The AASB agrees with the general thrust of the key paragraphs of the IASB’s summary of preliminary views on recognition (i.e. paragraphs 4.24 – 4.25 of the DP). That is, the AASB agrees that:

(a) an entity should recognise all of its assets and liabilities, except those for which recognition would not meet the fundamental qualitative characteristics of relevance and faithful representation and/or would not provide sufficiently useful information that the benefits of recognition would exceed the related costs[54]; and

(b) “If some assets or liabilities are not recognised, the resulting depiction of the entity’s resources and obligations would be incomplete and would thus provide a less faithful representation of the entity’s financial position” (paragraph 4.24 of the DP).

B20 The AASB considers that an implication of the statement in the DP quoted in paragraph B19(b) above is that, to achieve faithful representation:

(a) an entity should recognise all assets and liabilities (subject to the proviso in paragraph B19(a) above); and

(b) this includes recognising assets and liabilities with highly uncertain cash flows at a best estimate of the measurement attribute being depicted (instead of omitting to recognise them because of the degree of uncertainty) after disclosing all necessary descriptions and explanations, consistent with paragraph 4.25(b) of the DP.

AASB’s recommended modified ‘ideal’ approach to recognition

B21 Despite the AASB’s views set out in paragraphs B19 – B20 above, the AASB considers that some form of probability-based criterion for recognition of assets and liabilities should be included in the revised IASB Conceptual Framework, essentially for ‘policy’ reasons. Those reasons are:

(a) recognising all rights and obligations regardless of probability of outcome would appear to require entities to search ‘endlessly’ for potential rights and obligations, including those that are remote but still potentially material because of their amount (a similar point is included in paragraph 2.33 of the DP). Adopting some form of probability-based criterion for recognition would therefore arguably be an application of the principle, referred to in paragraph B19(a) above, that the benefits of recognition should exceed the related costs (see also paragraph B33 below); and

[54] This description does not wholly accord with paragraphs 4.24 – 4.25 of the DP. However, the differences seem sufficiently minor not to warrant discussing them in this Appendix dealing with the AASB’s other highly significant concerns with the DP.

(b) recognising in financial statements elements with only a remote chance of the outcome occurring would detract from the other recognised elements in financial statements. For example, the AASB thinks a frivolous claim against an entity for a very large sum of alleged damages but with only a remote chance of success would not warrant recognition because its carrying amount (as a point estimate) would be qualitatively different from other amounts of elements recognised in the financial statements[55].

B22 The AASB considered two possible probability-based recognition criteria that would address both of the arguments in (a) and (b) above, namely, the 'probable' criterion presently in paragraph 4.38(a) of the IASB Conceptual Framework, and a 'more than remote' criterion. The AASB prefers a 'probable' criterion because it reflects management's best assessment of whether an inflow or outflow of economic benefits will occur.

B23 The AASB considers that the 'probable' criterion as worded in paragraph 4.38(a) of the existing IASB Conceptual Framework should be retained (namely, "it is probable that *any future economic benefit associated with the item* will flow to or from the entity"; emphasis added) and that 'probable' should be defined as "more likely than not" (consistently with the definition of 'probable' in Appendix A of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*). In this regard, the reference to "any future economic benefit associated with the item" in paragraph 4.38(a) of the existing IASB Conceptual Framework is crucial, as it is much broader than the reference to the "*ultimate* inflow or outflow" of economic benefits in paragraph 2.35(c) of the DP. The significance of this is explained below in the AASB's comments on particular concerns noted in the DP regarding the 'probable' criterion for recognition (see paragraphs B25 – B31 below).

B24 The AASB considers that the 'probable' criterion should apply, neutrally, to assets and liabilities. It also considers that the 'probable' criterion should apply to the issues raised in both Question 3(b) and Question 3(c) in the DP's Invitation to Comment. That is, the criterion should apply when it is uncertain whether an asset or a liability exists (existence uncertainty, discussed in paragraphs 2.20 – 2.31 and 2.35 of the DP), and in testing whether to recognise an asset or a liability that exists but might not give rise to an inflow or outflow of economic benefits (outcome uncertainty, discussed in paragraphs 2.32 – 2.36 of the DP[56]).

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[55] Whether such a claim would warrant disclosure would depend on whether the claim is material. Disclosing information about such a claim should not give rise to the cost/benefit issues referred to in paragraph B21(a) above, because the entity would not need to search for its existence.

[56] However, the AASB would not support equating 'outcome uncertainty' with the 'ultimate inflow or outflow' of economic benefits (as that notion is discussed in paragraph 2.35(c) of the DP). The AASB considers that focusing on the 'ultimate inflow or outflow' can, in effect, subject the wrong asset or liability to a 'probable' criterion for recognition: see the explanation of this concern in paragraphs B26 – B29 below.

Comments on particular concerns noted in the DP regarding the 'probable' criterion for recognition

B25 The AASB acknowledges that similar assets and liabilities might be treated differently according to whether they fall slightly above or below a 'probable' threshold (or, for that matter, any other probability-based threshold), e.g. as noted in paragraph 2.35(c) of the DP. However, the AASB considers that:

(a) applying a probability-based threshold would not involve a 'cliff' in the reporting of information about assets and liabilities that fall on either side of that threshold. Although the AASB considers that disclosure cannot fully compensate for an omission to recognise an asset or a liability[57], it notes that recognition is one of the ways of reporting information about an entity's assets and liabilities (i.e. is part of an information spectrum). Disclosures about assets and liabilities that fail a probability-based threshold for recognition would still provide important information about the entity's financial position;

(b) for the reasons outlined in paragraphs B26 – B31 below, relatively few assets and liabilities would fail the 'probable' criterion for recognition in the existing IASB Conceptual Framework, if that criterion is applied appropriately. Therefore, guidance clarifying the application of that 'probable' criterion could significantly reduce the extent of the 'comparability' problem acknowledged in the lead-in of this paragraph; and

(c) concerns about falling on either side of a threshold (e.g. as noted in paragraph 2.35(c) of the DP) are exaggerated by implying a level of precision in probability assessments that would be uncommon in practice.

B26 As mentioned in paragraph B23 above, the AASB considers that the reference to "any future economic benefit associated with the item" in the 'probable' criterion in paragraph 4.38(a) of the existing IASB Conceptual Framework is crucial to how that recognition criterion should be interpreted, as it is much broader than the reference to the "*ultimate* inflow or outflow" of economic benefits in paragraph 2.35(c) of the DP. The AASB considers that the argument in paragraph 2.35(c) of the DP that "uncertainty about the *ultimate* inflow or outflow should not, by itself, determine whether an entity recognises an asset or a liability" mischaracterises the context of the existing probability criterion for recognition in the IASB Conceptual Framework. This is because the existing criterion does not refer to the "ultimate inflow or outflow" of economic benefits—it refers to "any future economic benefit associated with the item". The implications of this distinction are illustrated in the example in paragraph B27 below.

B27 An example highlighting the AASB's concerns about the DP's references to "ultimate inflow or outflow" of economic benefits is how those references might be applied to a non-transferable insurance policy written by a AAA-rated insurer

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57 This view is broadly consistent with the comment on this issue in paragraph 4.37 of the existing Conceptual Framework, as alluded to in paragraph 4.24 of the DP.

giving protection against a remotely likely event. The holder of the policy (the insured) has purchased a promise to provide the service of risk protection, which it can enforce against the insurer. Unless and until a loss occurs, the insured does not have an enforceable right to receive compensation for the insured-against event. Nevertheless, applying the existing ‘probable’ criterion in paragraph 4.38(a) of the Framework, it would be concluded that it is probable (in fact, virtually certain) that the insured will receive future economic benefits from its insurance policy; those economic benefits being the service of risk protection. The ‘ultimate inflow’, in this context, would appear to be the claim compensation, which is only remotely likely to become due and subsequently received. The AASB would agree that recognition of the policy asset of the insured should not be precluded by the ‘ultimate inflow’—the claim compensation—not being probable of being received. However, the AASB also considers that, unless and until the insured-against event occurs, the ‘ultimate inflow’ is not the economic resource embodied in the policy asset (i.e. the insured party does not have a present claim to the ‘ultimate inflow’) and therefore should not be the subject of the ‘probable’ test. In this example, the right to receive risk protection services is the asset, and whether those services will be received should be the subject of the probable criterion[58]. As illustrated in this example, applying a probability-based recognition to the ‘ultimate inflow or outflow’ could result in mis-specification of the asset being assessed for recognition[59]. (This reflects that the solution to various accounting conundrums is found in resolving the “which asset?” and “which liability?” questions.)

B28 Similar observations apply to the lottery ticket example discussed in paragraphs 2.14(e) and 2.32(a) of the DP. The AASB agrees with the comment in paragraph 2.14(e) that: “for a lottery ticket, the resource is the right to participate in the lottery, not the cash prize”. The AASB considers that the logical implication of that statement for applying the ‘probable’ criterion for recognition is that this criterion, if applied, would be applied to the service of being included in the draw, not to the cash prize (to which the ticket holder does not presently—and might never—hold an enforceable right). Consequently, the discussion of outcome uncertainty and a probability threshold in relation to the lottery ticket, in paragraph 2.32(a) of the DP, does not seem to make sense in light of the above-mentioned comment in paragraph 2.14(e) of the DP.

B29 Furthermore, for the same reasons as those set out in paragraphs B26 – B28 above, the AASB disagrees with the statement in paragraph 2.35(c) of the DP that including a probability threshold would lead to non-recognition of options that are judged to have a low probability or resulting in an inflow or outflow of economic benefits[60].

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58 Although the value of the right to receive risk protection services is affected by the possible amounts and associated probabilities of any claim compensation that might be received, that value is not the focus of the ‘probable’ criterion for recognition. That criterion is concerned with *whether* economic benefits will be received, not their value.

59 In effect, it would constitute applying a probability-based recognition criterion to an asset or a liability that does not presently exist (and that therefore should not be the subject of potential recognition as at the reporting date).

60 That is, the writer of the option renders a service of standing ready to transfer an economic resource if the holder exercises the option. This occurs even if the option is deeply out of the money: such a

B30 The points made in paragraphs B26 – B29 above illustrate why the AASB thinks relatively few assets and liabilities would fail the 'probable' criterion for recognition in the existing IASB Conceptual Framework, if that criterion is applied appropriately. Such assets and liabilities would be limited to:

(a) those for which the 'ultimate' uncertain outcome is the only transfer of economic benefits to which the 'probable' recognition criterion might be applied (see paragraph B31 below); and

(b) assets and liabilities in relation to a transfer of economic benefits preceding an 'ultimate' uncertain outcome [i.e. a promise to provide cash, another good or a service (a deliverable), such as the risk protection service illustrated in paragraph B27 above] for which it is not probable that the party making the promise will provide the deliverable[61].

B31 Therefore, the assets and liabilities that might fail a 'probable' criterion for recognition would exclude any involving an obligation to stand ready to provide cash, another good or a service (i.e. an asset, in the form of rights to the counterparty's obligation to stand ready; and a liability, in the form of the reporting entity's obligation to stand ready) for which it is probable that the party with a 'stand-ready obligation' will provide a service. The most obvious example of assets and liabilities that might fail a 'probable' criterion for recognition would be those arising in respect of non-contractual legal disputes, where normally no service related to the possible asset or liability is given or received before a claim receivable/payable (asset/liability) arises[62]. That is, for non-contractual legal disputes, the ultimate outcome is normally the only transfer of economic benefits to which a probability-based recognition criterion might be applied. In such cases, there is no need to refer to the 'ultimate outcome'; it seems fairly clear how to apply the 'probable' criterion in paragraph 4.38(a) of the existing IASB Conceptual Framework without such a reference.

B32 In the case of non-contractual legal disputes, the AASB considers that the respondent to the claim does not have an obligation to any party to provide a service of standing ready to meet the possible costs of an adverse outcome. This is because no promises have been made by the entity to any claimants, and the respondent's exposures to the costs of legal representation and the possible costs of an adverse

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circumstance affects the value of the service rendered by the writer and received by the holder, but not the probability of the service being rendered.

61 For example, in contrast to the example in paragraph B27 above, the entity acquires a warranty from an entity with a credit rating of C. Regardless of the likelihood of a warranty claim arising, it is concluded that it is not probable that the warranty provider will honour its promise to provide risk protection services, because the warranty provider is unable to provide those services. Circumstances in which it is not probable that a party with an unconditional present obligation would be willing and able to honour its obligation should be relatively unusual. These circumstances involve a different uncertainty than uncertainty regarding whether, depending on the outcome of an uncertain future event, an ultimate inflow or outflow of future economic benefits will be required (i.e. uncertainty whether a conditional obligation will become unconditional).

62 The reason for this view is set out in paragraph B32 below.

outcome are indistinct from other business risks, which are not of themselves present obligations.

B33 Because the AASB considers that relatively few assets and liabilities would fail the ‘probable’ criterion for recognition in the existing IASB Conceptual Framework, adopting the preliminary view that the reference to probability should be deleted from the recognition criteria should, in most cases, not result in a different outcome. However, the AASB considers it is important to retain the ‘probable’ criterion for recognition because, as mentioned in paragraph B21(a) above, the AASB is concerned that recognising all rights and obligations regardless of probability of outcome might require entities to search ‘endlessly’ for potential rights and obligations, including those that are remote but still potentially material because of their amount. In other words, whilst the AASB’s concern in paragraph B21(a) might infrequently be realised, entities might incur significant undue costs regardless of how few additional assets and liabilities would be recognised without applying the ‘probable’ criterion. Arguably, this cost/benefit (‘policy’) issue should be addressed only at a standards level. However, in view of the pervasive role of recognition criteria, the AASB considers it would be preferable to include a ‘probable’ criterion in the revised IASB Conceptual Framework. Addressing any form of probability-based recognition criterion in standards only would increase the risk that different, and potentially biased, recognition criteria would be set out in different standards (e.g. a higher recognition hurdle for assets than liabilities)[63].

B34 In summary, the AASB considers that the ‘probable’ criterion for recognition of an asset or a liability in paragraph 4.38(a) of the existing IASB Conceptual Framework should be retained (with brief guidance on how it should be applied), and that ‘probable’ should be defined as “more likely than not”. The IASB Conceptual Framework should also clarify the meaning and role of this recognition criterion.

Section 3—Additional guidance to support the asset and liability definitions

Present obligations

B35 The AASB disagrees with the preliminary views in the DP that:

(a) the Conceptual Framework should not limit the definition of a liability to obligations that are enforceable by legal or equivalent means, and the definition of a liability should encompass both legal and constructive obligations (paragraph 3.62); and

(b) of the three ‘Views’ of a present obligation (i.e. a liability) discussed in paragraphs 3.75 – 3.97 of the DP, the appropriate View is either ‘View 2’ or ‘View 3’ (paragraphs 3.96 – 3.97).

B36 The AASB considers present obligations must be enforceable against the entity. If a promise or stipulation is not enforceable against the entity, the entity cannot be

[63] As mentioned in paragraph A7 above, the AASB is concerned about the IASB’s preliminary views indicating that various pervasive issues should be addressed only at a standards level.

obliged to transfer an economic resource. The AASB thinks enforceable obligations include not only contractual terms that can be enforced in a court of law, but also equitable obligations that can be pursued through the law of equity.

B37 Therefore, unenforceable 'constructive obligations' should be excluded from the concept of a liability.

B38 The AASB disagrees with both View 2 and View 3 because they are too broad, i.e. they potentially include unenforceable obligations in the notion of a liability. The AASB is concerned that unenforceable obligations are inherently indistinguishable from economic compulsion. As paragraph 3.52 of the DP argues, economic compulsion is, of itself, insufficient for a present obligation to exist. However, if, as a result of applying View 2 or View 3, economic compulsion were implicitly treated as being, of itself, sufficient for a present obligation to exist, it would be logical for present obligations to be identified when an entity considers it is economically compelled (in the absence of an enforceable obligation) to:

(a) pay salaries for future services by employees;

(b) repair or replace assets essential to the continued operation of the entity's existing business; and

(c) undertake staff training to comply with industry regulations [this example is specifically excluded from provisions (as non-liabilities) by Example 7 of the Implementation Guidance accompanying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*].[64]

The AASB would strongly disagree with such an outcome.

B39 In relation to its concern in paragraph B38 above, the AASB acknowledges that paragraph 3.60 of the DP notes the arguments in favour of restricting the definition of a liability to enforceable obligations. However, the DP does not seem to thoroughly draw out the negative consequences of treating economic compulsion as being, of itself, sufficient for a present obligation to exist (as demonstrated in the fourth sentence of paragraph B38 above).

B40 Whilst View 1 comes closest to the AASB's view that a liability must be enforceable, in some respects[65] it seems a broader view of a present obligation than the AASB's. This is because some unconditional obligations (in respect of which

[64] In relation to when present obligations arise under 'View 2' and 'View 3' (the Views the IASB did not reject in the DP), the DP seems to emphasise the past event of having received a benefit as a source of a present obligation (e.g. paragraphs 3.65(a) – 3.65(b), 3.66, 3.78(a) and 3.84 – 3.87 of the DP). This might be seen as a reason why these examples of economic compulsion would be insufficient for a present obligation to exist. However, the AASB would not support making the existence of a liability dependent on whether assets have been received. For some present obligations, such as enforceable obligations to perform environmental restoration, the entity might incur the present obligation as a result of events other than the receipt of assets.

[65] See also paragraph B41 below, which indicates that, whilst present obligations would not be identified under View 1 in respect of the scenarios in paragraph 3.73 of the DP, in similar circumstances to some of those described in paragraph 3.73, present obligations would be identified under the AASB's 'enforceable obligations' view.

the entity might consider itself unable to avoid future transfers of economic resources) might be unenforceable. In other words, a promise or stipulation might not depend on a future event before the recipient of the promise is 'entitled' to a transfer of economic benefits, but that other party (or a party acting on its behalf) cannot enforce its entitlement against the entity. For example, a valid insurance claim is made against an insurer by an insured resident of another country (who holds a policy with the insurer); however, due to a subsequent cancellation of reciprocal legal arrangements between the countries of the insured and the insurer, the insured has no mechanism (legal or otherwise) with which to enforce its claim. Nevertheless, the AASB considers it would be highly unusual for an unconditional obligation to be unenforceable.

B41 In other respects, View 1 seems a potentially narrower view of a present obligation than the AASB's. Applying the AASB's view that present obligations must be enforceable against the entity may (depending on jurisdiction-specific circumstances) result in identifying present obligations in similar circumstances to those described in some scenarios in paragraph 3.73 of the DP. (In contrast, for the particular fact patterns assumed in each of those seven scenarios, the DP identifies the application of View 1 as not resulting in identification of a present obligation.[66]) For example:

(a) the circumstances described in Scenario 1 might not reflect the legal environment in some jurisdictions[67]. In some jurisdictions, unlike the assumed fact pattern in Scenario 1, employees might have a legal right of recourse against an employer that terminated their employment contract as the vesting date for an employee bonus approaches[68]. If so, the employees would hold a valuable legally enforceable contractual option to continue rendering services and qualify for the bonus (or compensation in lieu thereof)[69]—'legally enforceable' and 'legally vested' should not be regarded as synonymous; and

(b) in analogous circumstances to those described in Scenario 2, a present[70] obligation might exist without the entity having reached a threshold[71]. For example [*a non-revenue variation of Scenario 2*], if an operator of a landfill site is subject to an enforceable levy for methane emissions above a certain amount, and that entity's best estimate is that (without remedial action) it will unavoidably pass that threshold in a future period as a lagged effect of burying substances in the current period, the entity would incur a present (and growing) obligation as the substances are buried. Any future action by

66 However, it is unclear what the treatment of these similar circumstances below would be under View 1.

67 This is not a criticism of the DP. Instead, the AASB is cautioning against assuming that the same conclusions about whether a present obligation exists should be reached in analogous circumstances.

68 This might also be the case with unvested long service leave, which raises essentially the same issues as employee bonuses but accrues rateably as employee services are rendered.

69 The employer would have a real option to terminate their employment and pay any compensation amount enforced against it. However, that option would not nullify the existence of a present obligation of the employer.

70 i.e. enforceable

71 These remarks about the significance of reaching a threshold are not confined to revenue thresholds, which Scenario 2 illustrates.

the entity in paying or avoiding the levy (in the latter instance, by taking remedial action) would require a future transfer of economic resources. Therefore, the entity would have a present obligation (i.e. avoiding the levy would not avoid a future transfer of economic resources).

For these reasons, the AASB considers that whether a present obligation exists in respect of a levy (or other impost) involving a threshold would not, of itself, depend on whether the entity has reached the threshold.

B42 The AASB recommends that, instead of adopting one of Views 1 – 3 discussed in paragraphs 3.75 – 3.97 of the DP, the IASB adopts the principle that a present obligation must be enforceable against the entity.

Section 4—Recognition and Derecognition

Derecognition

Main concern

B43 The AASB disagrees with the preliminary view (expressed in Question 9 of the DP) that: "if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction". The AASB considers the IASB Conceptual Framework should contain derecognition concepts that would cover all types of transactions that potentially give rise to derecognition of an asset or a liability (or a component of an asset or a liability). This would not preclude setting out more detailed requirements or guidance on derecognition in particular Standards (which could be inconsistent with these concepts – with accompanying rationale for any deviations from the concepts).

B44 The AASB's reasons for its view in paragraph B43 above are set out below, together with comments on the aspects of the DP's discussion of derecognition with which the AASB agrees (for context).

Background and elaboration

B45 The AASB agrees with the statement in paragraph 4.34 of the IASB DP that:

> "The aim of accounting requirements for a transaction that may result in derecognition should be to represent faithfully both:
>
> (a) the resources and obligations remaining after the transaction; and
>
> (b) the changes in the resources and obligations as a result of the transaction."

B46 The AASB also agrees with the preliminary view, reprised in Question 9 of the DP, that "an entity should derecognise an asset or a liability when it no longer meets the

recognition criteria" (i.e. it should apply the 'control approach' to derecognition)[72]. The 'control approach' has the advantage of being neutral between initial recognition and subsequent recognition (e.g. in assessing whether an element meets the criteria for recognition, it would be irrelevant whether the element had previously been recognised).

B47 However, the AASB disagrees with the preliminary view that the IASB Conceptual Framework should provide only limited-scope conceptual guidance on derecognition. Specifically, the AASB disagrees with the preliminary view that, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. This scope limitation seems to be manifested in the discussion of Example 4.1 ('Sale of receivables with partial recourse') and Example 4.2 ('Sale of a bond with repurchase agreement') in paragraphs 4.39 – 4.44 of the IASB DP. In relation to those examples, the DP discusses the respective merits of the 'control' approach and the 'risks-and-rewards' approach, without appearing to identify a preferred approach in those circumstances.

B48 In relation to Examples 4.1 and 4.2 discussed in paragraphs 4.39 – 4.44 of the DP, the DP identifies concerns that derecognition of assets or liabilities using a control approach can lead to recognition of gains or losses from transactions that change neither the amount nor riskiness of the entity's expected future cash flows. The AASB agrees that derecognition of assets or liabilities using a control approach can lead to recognition of gains or losses in those circumstances. However, the AASB considers that recognition of these gains or losses would reflect earlier unrecognised gains and losses (i.e. changes in the values of the assets or liabilities transferred). In concept, those gains and losses should be recognised when the changes in the values of the assets and liabilities occurred. However, if a conceptual decision were made not to remeasure assets and liabilities before they are derecognised, recognising a gain or loss as at a date upon which neither the amount nor riskiness of the entity's expected future cash flows changed would not be a conceptual flaw (rather, it would be a consequence of other conceptual decisions). This is because an economic phenomenon that occurred previously but was not recognised at the time is now being recognised. The AASB considers it would not be representationally faithful if derecognition of an asset or a liability that no longer meets the conceptual recognition criteria were to be delayed, and gains or losses were to be deferred beyond the existence of the asset or liability that gave rise to them, simply because gains or losses are recognised when neither the amount nor riskiness of the entity's expected future cash flows changed. Deferral of those gains and losses in the statement of financial position would include in that statement items that are not economic phenomena.

B49 The AASB considers that, conceptually, in all cases, an entity should derecognise an asset or liability when the asset or liability no longer meets the recognition criteria, i.e. the 'control approach' should always be applied.

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[72] However, note the AASB's views regarding recognition criteria in paragraphs B18 – B34 above.

B50 As mentioned in paragraph B47 above, the AASB disagrees with the preliminary view that, if the entity retains a component of an asset or a liability, the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. The AASB considers that, to facilitate a coherent and principles-based approach to derecognition in those circumstances, the Conceptual Framework should identify derecognition concepts for these transfers. Otherwise, ad hoc and/or inconsistent decisions might be made in different Standards-level projects. As noted in paragraph B43 above, this would not preclude departing from those concepts in standards-level projects, where such departure is justified.

B51 The AASB notes that one of the possible treatments referred to in paragraph 4.50(c) of the DP 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. The AASB considers that the IASB Conceptual Framework should not identify this treatment as being potentially acceptable in concept, because it would not be representationally faithful to recognise in full an asset or a liability that has partially been transferred to another entity. Accordingly, that treatment would not seem to meet the aim in paragraph 4.34(a) of the DP that the financial statements represent faithfully the resources and obligations remaining after the transaction.

B52 In relation to paragraph B51 above, in other words, the AASB considers that conceptual support should not be given to notions of derecognising assets and liabilities either in their entirety, or not at all, as a result of a transaction. Such notions would be inconsistent with the IASB's preliminary view that a components approach should be taken to accounting for assets and liabilities, e.g. that economic resources should be defined as rights or other sources of value capable of producing economic benefits (paragraph 3.4 of the DP, as referred to in paragraph 3(b) above). Derecognition concepts in relation to assets (or components of assets) should focus on which rights or other sources of value the entity has ceased to control, rather than on whether the 'host' object (e.g. physical item) has been transferred or fully consumed.

Recommendations

B53 The AASB recommends stating in the IASB Conceptual Framework that, in accounting for a transaction involving the derecognition of some components of an asset or a liability:

(a) the partial derecognition approach should be applied in respect of any components of an asset or a liability that are retained by the entity; and

(b) the full derecognition approach should be applied to any other components, with initial recognition[73] of the new or substantially different[74] rights or obligations arising from the transaction.

[73] Subject to meeting any recognition criteria.
[74] See paragraph B54 below.

B54 The AASB also recommends including guidance (broadly consistent with paragraph 4.49 of the DP) that a component of an asset or a liability should not be treated as being retained if its character has changed significantly. If that component has changed significantly, it should be regarded as an entirely new asset, and the full derecognition approach should be applied to it. The AASB also recommends that any definitive guidance on the meaning of a significant change in the character of a component should be developed at a standards level. However, it would be useful for the IASB Conceptual Framework to include one or two examples of when the character of a component does, or does not, change significantly.

B55 A possible example is a sale and leaseback of an item of equipment (which is the subject of Example 4.3 within paragraph 4.46 of the DP). The vendor loses all of the rights listed in paragraph 3.6 of the DP, apart from the right to use the equipment for a specified period to produce goods or provide services, fulfil liabilities or reduce expenses (which it retains). However, the enjoyment of that right of use is, as a result of the sale and leaseback, affected by the risk of non-performance by the lessor in providing quiet enjoyment of equipment that is properly maintained and therefore fit for purpose. Therefore, it seems that the character of that right of use has changed so much that the right should be regarded as an entirely new asset—i.e. a full derecognition approach would seem appropriate.

B56 The AASB recommends that the IASB Conceptual Framework does not raise the possibility that if the entity retains a component of an asset or a liability, possible standards-level approaches include:

(a) enhanced disclosure; and

(b) presenting any rights or obligations retained on a line item different from the line item that was used for the original rights or obligations, to highlight the greater concentration of risk.

B57 The reasons for the AASB’s recommendations in paragraph B56 above are:

(a) including the conceptual guidance recommended in paragraphs B53 – B55 above should obviate the need to rely on presentation and disclosure approaches to deal with transactions in which components of assets or liabilities are retained; and

(b) the possible approaches identified in the DP as repeated in paragraph B56 above raise the risk of increasing the complexity of display in financial reports. This is a concern to the AASB, in view of the AASB’s concern (noted in paragraphs A39 – A43 above) that Section 7 of the DP (on presentation and disclosure) includes preliminary views that seem an inadequate conceptual basis for rationalising presentation and disclosure in financial reports and thereby addressing the ‘disclosure overload’ problem.

B58 As mentioned above in paragraphs B51 – B52 above, and for the reasons given in those paragraphs, the AASB also recommends that the IASB Conceptual Framework does not acknowledge the possibility of continuing to recognise (in full)

the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.

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

'Directly' remeasuring secondary equity claims

B59 The AASB disagrees with the preliminary view that, at the end of each period, an entity should update the measurement of each class of equity claim and consequently show transfers between the amounts of recognised net assets attributed to each class of equity, within the statement of changes in equity (paragraphs 5.12 – 5.13 of the DP). The AASB's concern is focused on the apparent implication that secondary equity claims would be measured 'directly', for example, in the same manner as an entity would measure a comparable financial liability – as illustrated in Example C2 in paragraphs C8 – C17 of Appendix C to the DP (that example illustrates that, for a written put option with settlement net in shares, changes in the fair value of the option could be recognised as a transfer between a class of equity termed 'obligation to issue shares' and retained earnings). The AASB does not have concerns regarding the DP's discussion of how primary equity claims would be measured, because there is no indication in the DP that these claims would be measured differently from their conceptually appropriate treatment under the existing Conceptual Framework, that is, using an allocation of the underlying net assets.

B60 The AASB disagrees with 'directly' remeasuring changes in some classes of equity because, as elaborated below, it:

(a) conflicts 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;

(b) seems unlikely to meet its stated aims; and

(c) seems unnecessary.

B61 Regarding paragraph B60(a) above, the AASB notes that paragraph BC1.8 of the Basis for Conclusions on the IASB Conceptual Framework refers to the separation between a reporting entity and its equity investors and says:

> "… the Board concluded that financial reports should reflect that separation by accounting for the entity (and its economic resources and claims) rather than its primary users and their interests in the reporting entity."

B62 In relation to paragraphs B60(a) and B61 above, the AASB considers that accounting for economic phenomena only affecting other parties, such as particular equity claimants, would be incompatible with meeting the common information

needs of users (as referred to in paragraph OB8 of the IASB Conceptual Framework).

B63 Regarding paragraph B60(b) above, relative changes in values of different classes of equity instruments are changes in market values of those instruments. These would differ from amounts attributed to those claims for financial reporting purposes because:

(a) the recognised amount of net assets typically is composed of a mixture of historical and current measurements of assets and liabilities[75]; and

(b) market values of equity interests reflect the amounts, timing and uncertainty of expected future cash flows from the entity, which include future cash flows from items not recognised as assets and liabilities.

B64 In relation to the point made in paragraph B63(b) above, the AASB notes that, when a secondary equity claim is an option to buy or sell an entity's shares, changes in the market value of the option would differ from changes in the value of the entity's net assets—even if all assets and liabilities were measured at fair value—because the market value of such an option reflects expectations about future events that are not included in the fair values of assets and liabilities. For example, the market value of such an option includes the option's 'time value', which is affected by expected volatility in the market price of the entity's shares. Such volatility would be influenced by changes in the entity's recognised assets and liabilities, but would also be influenced by other factors.

B65 In the above-mentioned Example C2 in Appendix C to the DP, for a written put option with settlement net in shares, changes in the fair value of the entity's shares (and thus of the options) have no effect on the reporting entity's assets and liabilities, and no effect on that entity's future cash flows. Thus, with reference to the stated aim in paragraph 5.11(b) of the DP, those value changes seem to have no information value regarding the amounts of future distributions of cash by the entity to holders of different classes of equity claims.

B66 To extend the point made in paragraph B63(b) above, transfers of value between each class of equity claims could only be recognised in a comprehensive manner if the entity's market capitalisation were recognised in equity and disaggregated into different classes. However, this would require valuing the reporting entity, rather than recognising the entity's assets and liabilities, and would conflict 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".

B67 Regarding paragraph B60(c) above, the AASB considers that adopting the IASB's preliminary view would be unnecessary because the fair value of different classes of equity instruments typically is ascertainable from market information outside financial statements. In light of this, and because financial statements are not

[75] However, as mentioned in paragraphs 14 – 18 of this submission, the AASB considers that, in concept, all recognised assets and liabilities should be measured at a current value based on an identified ideal concept of wealth.

intended to report the values of owners' equity instruments, it is unclear which problem the IASB's preliminary view regarding remeasuring equity claims is intended to solve.

B68 The AASB considers that, in the above-mentioned Example C2, it would be conceptually appropriate to treat the option premium as a contribution by owners when the option is written. Although the 'owner' (option holder) may subsequently relinquish their right of access to the entity's shares, such a subsequent event would not affect the 'capital' character of the transaction when the option premium was paid to the entity. From the entity's perspective, it seems irrelevant how many equity holders have a remaining right to benefit from their equity contributions, or whether the option holder was speculating on a possible short-term increase in the option's price when it purchased the option.

B69 The AASB also observes that remeasuring equity claims of non-controlling interests (NCIs) in accordance with IFRSs does not (as asserted in paragraph 5.21 of the DP) represent a precedent for 'directly' remeasuring some classes of equity claims. This is because NCIs are 'indirectly' remeasured each period for the change in the underlying recognised net assets attributable to them.

Financial instruments puttable for a proportionate share of the entity's net assets

B70 In relation to puttable financial instruments that:

(a) give the holders a pro rata residual interest in the entity's net assets, after deducting all its liabilities; and

(b) 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,

the AASB disagrees with 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" if that preliminary view is intended to indicate that, in concept, some liabilities should be treated as equity.

B71 The AASB would disagree with that preliminary view because the AASB:

(a) supports the preliminary view in paragraph 5.37 of the DP that the 'strict obligation' approach is preferable to the 'narrow equity' approach to distinguishing liabilities from equity (i.e., consistent with paragraph 5.34 of the DP, only obligations to deliver economic resources would be classified as liabilities, and all equity claims would be classified as equity). The preliminary view referred to in paragraph B70 above would represent an exception from the 'strict obligation' approach because it would seem to state that, in concept, some obligations to deliver economic resources should be classified as equity; and

(b) considers that, as a matter of principle, exceptions within the IASB Conceptual Framework should not be made if that Framework is to contain robust general concept(s) for classification of claims on an entity's assets (as liabilities or equity). Whilst exceptions from the concepts might be warranted at a standards level, with full explanation of the reasons for those exceptions, they should not become part of the concepts.

B72 The AASB notes that paragraph 5.57 of the DP says, in relation to the preliminary view referred to in paragraph B70 above: "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."[76] The AASB considers that there might be valid conceptual reasons to identify the puttable instruments described in paragraph B70 above as equity instruments (see paragraph B75 below). However, these reasons do not include the above-mentioned argument in paragraph 5.57 of the DP.

B73 The AASB would be concerned that a logical extension of the argument referred to in paragraph B72 above would be that any entity should treat the most subordinated class of instruments it issues as equity. Such an extension of the application of that argument would create tension with the preliminary view that the 'narrow equity' approach to distinguishing liabilities from equity should not be adopted in the IASB Conceptual Framework.

Addressing only at a standards level whether to bifurcate the puttable instruments at fair value into liability and equity components

B74 The AASB disagrees with the suggestion in paragraph 5.58(b) of the DP that it would address at a standards level only[77] the issue of whether to bifurcate the puttable instruments into an embedded put option (for which a liability would be recognised) and a host equity instrument. The AASB considers this issue should first be addressed (at least broadly) in developing the revised IASB Conceptual Framework, because the issue is conceptually significant and its resolution would provide insights into the robustness of the proposed conceptual definitions of a liability and of equity.

[76] However, 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." Therefore, the AASB finds the IASB's plans ambiguous – see comments on this in paragraph A8(d) above as an example of a concern about 'deferral' of issues to standards-level projects.

[77] Subject to undertaking a project to amend the relevant Standards.

Addressing whether a required distribution of assets would be a capital reduction

B75 In relation to the puttable instruments described in paragraph B70 above, the AASB encourages the IASB to consider the logic of the following approach[78]:

(a) if the value of the assets to be delivered upon early redemption is proportionate to the entity’s net assets, the distribution of assets would be a capital reduction (the option holder would realise its share of the business), that is, it would be a distribution to an owner. If the instrument does not convey to the holder rights to also demand a non-proportionate transfer of the entity’s net assets, the instrument would be wholly equity in nature (it would be a proportionate interest in the entity’s net assets that therefore exposes the holder to the risks and rewards of ownership of the entity’s ordinary share capital); and

(b) if the holder of the option also has rights to demand a transfer of assets that is not proportionate to the entity’s net assets, those additional rights would represent liabilities, and the instrument should be bifurcated into liability and equity components (see paragraph B74 above).

B76 In relation to paragraph B75(b) above, it should not be presumed in concept that any liabilities in respect of the puttable instruments would be measured at the amount potentially puttable, without taking into account the probability of the put option being exercised. Paragraph 5.56 of the DP notes one of the main concerns with treating the puttable instruments described in paragraph B70 above as giving rise to liabilities is that, under IFRSs, they consequently would be required to be recognised at not less than the amount payable on demand [paragraph 47 of IFRS 13 *Fair Value Measurement* says: “The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid”]. Paragraph 5.56 of the DP also notes that such treatment could therefore result in the entire market capitalisation of the entity being recognised as a liability (depending on the basis for calculating the redemption value of the financial instruments) and this liability amount could even result in the entity reporting negative net assets. However, the AASB considers that the revised IASB Conceptual Framework should not adopt (explicitly or implicitly) the above-mentioned requirement in paragraph 47 of IFRS 13 as the measurement concept for the put option liability component. The AASB thinks that, regardless of how this issue is treated at a standards level in the future, it would be conceptually consistent with the ‘spirit’ of the guidance on fair value in paragraph 24 of IFRS 13[79] to measure the fair value of

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78 This approach deals with the case in which there exists one class of equity. The approach could be refined to address cases in which there are two or more classes of equity, each with different equity rights.

79 i.e. in relation to a liability, “Fair value is the price that would be … paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price) …”. The price that would be paid to transfer a liability should reflect the probability of a transfer of economic resources being required; however, this is not reflected in the guidance in paragraph 47 of IFRS 13 on the fair value of a financial liability with a demand feature (quoted above in this paragraph).

such put option 'liabilities' at an amount that takes into account the probability of the put being exercised. Therefore, if a puttable instrument is bifurcated into liability and equity components, applying a residual approach to measure the equity component should not result, in concept, in measuring that component at nil.

B77 The AASB considers that the logic enunciated in paragraph B75 above would be consistent with the 'strict obligation' approach preferred by the IASB (with which the AASB concurs). Paragraph 5.34(b) of the DP says, under the 'strict obligation' approach, all equity claims would be classified as equity—"in other words … all claims that give the holder the right to receive a portion of any distributions of equity made to holders of that class of claim". An important difference between the 'strict obligation' approach and 'narrow equity' approach discussed in the DP is those approaches' different treatments of whether liabilities should include obligations that would be settled without transferring assets of the entity. The logic in paragraph B75 above would not involve treating as liabilities obligations that would be settled without transferring assets of the entity, and thus would be consistent with this important aspect of the 'strict obligation' approach[80].

B78 Adopting the logic described in paragraph B75(a) above for instruments puttable for a proportionate share of the entity's net assets would have the advantage that the instrument held by an owner acting in their capacity as an owner would not be remeasured (and thus changes in the value of the instrument would not be recognised in the entity's economic income). This would be consistent with the principle (reflected in the definitions of 'income' and 'expenses' in paragraph 4.25 of the existing IASB Conceptual Framework) that an entity does not generate income or expenses from dealing with owners acting in their capacity as owners, and would thus avoid the problem with liability classification of these puttable instruments noted in paragraph 5.56(b) of the DP.

B79 In addition, under the logic described in paragraph B75(a), once the put option is exercised and an amount that will not vary subsequently in response to changes in the entity's net assets becomes payable, the instrument would be reclassified as a liability until it is extinguished through payment. For the period (probably brief) between exercise and extinguishment of the option, the relationship between the instrument holder and the entity becomes that of a creditor rather than an owner; i.e. the holder ceases to be exposed to the risks and rewards of ownership of the entity's ordinary equity capital.

Implications for classification of obligations to issue equity instruments

B80 The AASB considers that the IASB should, in developing its revised Conceptual Framework, explore the potential implications of adopting the logic in paragraph B75 above for the classification of obligations to deliver equity instruments (discussed in paragraphs 5.28 – 5.44 of the DP). When an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (as referred to in paragraph 5.29 of the DP):

[80] However, see paragraph B80 below.

(a) some commentators argue that the transaction (i.e. entry into the contract) is not with an owner acting in its capacity as an owner, and therefore should be classified as giving rise to a liability rather than equity. That is, they argue that the transaction is with a creditor. (Subsequently, when the equity instruments are issued, the holder of those instruments will commence a relationship with the entity of an owner acting in its capacity as an owner, because, from that point on, the holder is exposed to the risks and rewards of ownership of the entity's ordinary share capital.) These commentators:

  (i) argue there is little economic difference between an entity issuing shares for cash and using the cash as consideration for acquiring an asset, and using a promise to issue shares of the same value as consideration for the acquisition of the same asset; and

  (ii) consider it would be logical to reach consistent conclusions regarding the classification of instruments puttable for a proportionate share of the entity's net assets and of obligations to issue equity instruments; and

(b) other commentators argue that the transaction should be classified as giving rise to equity, because they consider an essential characteristic of a liability is an obligation to transfer assets, regardless of whether the transaction gives rise to the counterparty becoming exposed to the risks and rewards of ownership of the entity's ordinary share capital. These commentators support applying the logic in paragraph B75 above to liability/equity classification of puttable instruments described in paragraph B70 above, noting it would be consistent with the 'strict obligation' approach, but consider that extending application of that principle to transactions in which an entity uses its own equity instruments 'as currency' in a contract would be inconsistent with the 'strict obligation' approach (which they support).

B81 Given these views noted in paragraph B80 above, the AASB recommends that the IASB considers jointly the classification of the puttable instruments described in paragraph B70 above and of obligations to issue equity instruments.

Non-controlling interests in an entity's equity

B82 The AASB observes that paragraph 5.21 of the DP seems to presume that separate presentation of non-controlling interests (NCI) in an entity's equity would continue under the revised IASB Conceptual Framework. The DP does not discuss the issue of whether, *in concept*, it is appropriate to continue such separate presentation, even if the presentation requirements for NCI were retained in IAS 1 *Presentation of Financial Statements*. The AASB considers that the DP should have discussed this issue because:

(a) the existing IASB Conceptual Framework does not include a reference to the presentation of NCI; and

(b) a parent/NCI distinction apparently reflects a parent perspective, rather than an entity perspective, to an entity's financial reporting.

B83 In relation to paragraph B82(b) above, the AASB notes that a parent perspective is a form of proprietary perspective to financial reporting. In contrast, an entity perspective is reflected in key aspects of the IASB Conceptual Framework. Specifically:

(a) the objective of general purpose financial reporting is to provide useful financial information about the reporting entity to creditors as well as investors (paragraph OB2); and

(b) general purpose financial reports provide information about the reporting entity's economic resources and claims (paragraph OB12), which are not limited to economic resources and claims attributable to the reporting entity's parent.

B84 In addition, as noted in paragraph B61 above, paragraph BC1.8 of the Basis for Conclusions on the 'Objective' chapter of the IASB Conceptual Framework says:

> "… the Board concluded that financial reports should reflect that separation [between a reporting entity and its equity investors] by accounting for the entity (and its economic resources and claims) rather than its primary users and their interests in the reporting entity."

B85 Under an entity perspective to financial reporting, whether some equity holders are controlling or non-controlling is irrelevant to the reporting entity. In addition, rights attaching to different classes of equity claims do not differ according to whether the interests are controlling or non-controlling (instead, they depend on the class).

B86 The AASB considers that, in developing an ED of the revised IASB Conceptual Framework, it would be inappropriate for the IASB to refer to the presentation of NCI in an entity's equity in the revised IASB Conceptual Framework.

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 flows[81].

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:

(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);

[81] 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.

(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 …"[82], 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
>
> "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 use[83]. 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 context[84].

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82 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.

83 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).

84 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.

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 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 liabilities[85]. This is because of:

[85] 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.

(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 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 date[86] 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.

B107 Nevertheless, the AASB considers that the two 'current value'[87] 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

[86] Except when current cost exceeds recoverable amount

[87] 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.

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.)

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 effectively[88]. In view of the degree of specialisation of resources necessary for entities to pursue their objective of generating above-market[89] 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

[88] 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.

[89] 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.

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 generally[90] 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 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).

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

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 period[91].

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 cost[92], the AASB considers that historical cost is not useful for predicting 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 expenses[93], 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

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91 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.

92 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 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).

93 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.

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 resource[94]. 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 identical[95] products during times of rising prices but one of them turns over its inventory more slowly than the other, the entity turning over its inventory more slowly would[96] 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

[94] 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.

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

[96] Assuming all other circumstances are the same.

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).

> 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 13[97]) 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

[97] 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).

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 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 factors[98]. 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 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 products[99]. 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

98 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).

99 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).

(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 risk[100], the current market entry price and current market exit price for monetary liabilities would be the same.

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 necessarily[101] 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.

[100] 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 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.

[101] That is, they would only do so for assets acquired recently.

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 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"[102]. 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

[102] 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,

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 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 prices[103] (rather than ascribing the entity's own values to that capability[104]). 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

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

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

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 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 wealth[105] ('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.

[105] 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.

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.

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 used[106]; and, when entity-specific cash flows are expected to differ from cash flows for other market participants, entity-specific cash flows would consistently be preferred[107])—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

[106] 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).

[107] 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 *historical cost* 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	*Historical cost* 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	*Historical cost* 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	*Historical cost* less accumulated amortisation and accumulated impairment losses; *or* 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)	*Amortised cost* less impairments based on the present value of estimated cash flows discounted using an *historical contractual rate*, for receivables expected to be realised within a short period; *or* 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)[108]	*Amortised cost discounted using an historical/contractual interest rate*, for trade or loan payables expected to be settled within a short period; *or* 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 *undiscounted* amount expected to be paid in respect of services already received (using entity-specific cash flows); *or* 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)

[108] 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	IAS 37 Current fulfilment/transfer value 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)	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[109] discounted at a current market rate)	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)
Insurance contract liabilities	IASB ED/2013/7 Current fulfilment value: 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.	Current fulfilment value 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).	Current fulfilment value 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), *plus any remaining element of the contractual service margin that does not represent services to be provided under the contract(s).*

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:

[109] 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.