



CHARTERED ACCOUNTANTS  
AUSTRALIA + NEW ZEALAND

5 November 2015

Ms Kris Peach FCA  
The Chair  
Australian Accounting Standards Board  
PO Box 204 Collins St West  
Melbourne Victoria 8007

By email: [standard@asb.gov.au](mailto:standard@asb.gov.au)

Dear Ms Peach

### **Submission on Exposure Draft ED 264: Conceptual Framework for Financial Reporting**

Thank you for the opportunity to comment on the Conceptual Framework for Financial Reporting Exposure Draft ("the ED"). We support the International Accounting Standards Board's (IASB) project to revise the Conceptual Framework ("the framework"). Providing a more complete, clear and updated set of concepts will improve financial reporting which is in the public interest. We have considered the ED and against this backdrop of support our comments are set out below.

We acknowledge that the intention of the ED is to build on the existing framework by updating and improving it. However, this project provides a rare opportunity to fundamentally reconsider important aspects of the framework that should not be overlooked. Most specifically, further exploration of the concept of what constitutes financial performance would be well received. There also remains a need for a single conceptual basis for the recognition of items of income or expense in 'other comprehensive income'. In relation to this, we recommend measurement concepts that best satisfy users' needs for information about financial performance and position be developed. In addition, we would prefer the distinction between debt and equity to be addressed in the framework itself rather than referred to a standards level project.

We believe the reintroduction of prudence to the framework is challenging as it contradicts the concept of neutrality. There is a risk that its reintroduction as a concept will serve as a rationale for overprovisioning and profit smoothing.

Appendix A (attached) provides responses to the specific questions raised in the ED. If you have any questions regarding this submission, please contact Dr Michael Fraser CA (Reporting Leader) via email; [michael.fraser@charteredaccountantsanz.com](mailto:michael.fraser@charteredaccountantsanz.com). Further information about CA ANZ is contained in Appendix B.

Yours sincerely

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## **Appendix A: Responses to specific questions**

### **Question 1—Proposed changes to Chapters 1 and 2**

**Do you support the proposals:**

- (a) to give more prominence, within the objective of financial reporting, to the importance of providing information needed to assess management’s stewardship of the entity’s resources;**
- (b) to reintroduce an explicit reference to the notion of prudence (described as caution when making judgements under conditions of uncertainty) and to state that prudence is important in achieving neutrality;**
- (c) to state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;**
- (d) to clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and**
- (e) to continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?**

**Why or why not?**

- (a) We support greater prominence being given to the assessment of management’s stewardship of the entity’s resources in the description of the objective of financial reporting in the ED. However, the proposed wording appears to relegate the assessment of management’s stewardship to being part of the decision on whether to buy, sell or hold equity and debt instruments. We recommend that assessment of stewardship be identified as an objective in its own right.
- (b) We caution against the proposal to reintroduce the prudence concept to the framework for the reasons it was previously removed. It was seen to detract from the concept of neutrality and was used to justify overprovisioning and profit smoothing.
- (c) We support the reintroduction of the concept of substance over form as it provides clarity to the meaning of faithful representation.
- (d) We caution against the proposal to clarify that measurement uncertainty is one factor that can make financial information less relevant. The reasoning provided in the Basis of Conclusions does not appear to be sufficiently compelling and is likely to be a source of further confusion. We believe the concept of measurement uncertainty is sufficiently explained in paragraph 2.19 which describes faithful representation.
- (e) We support relevance and faithful representation as the two qualitative characteristics of useful financial information.

### **Question 2—Description and boundary of a reporting entity**

**Do you agree with:**

- (a) the proposed description of a reporting entity in paragraphs 3.11–3.12; and**
- (b) the discussion of the boundary of a reporting entity in paragraphs 3.13–3.25?**

**Why or why not?**

We broadly agree with the description of reporting entity and the boundary of a reporting entity. We agree that there may be instances where a reporting entity is not a separate legal entity, but we believe that national standard setters are in a better position to deal with such circumstances. We understand the AASB is currently undertaking a review of the Australian reporting framework where one of the objectives of the project is to facilitate identifying which entities would be required to prepare general purpose financial statements. In light of this, we are comfortable with the broad definition proposed in the ED at this time.

**Question 3—Definitions of elements**

**Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):**

- (a) an asset, and the related definition of an economic resource;
- (b) a liability;
- (c) equity;
- (d) income; and
- (e) expenses?

**Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?**

We agree with the proposed definitions of the elements. However, when new standards are issued or current standards are amended, we believe there must be a commitment to address any departures from these definitions. We note that the IASB is continuing to explore how to distinguish liabilities from equity in a research project, including the investigation of potential amendments to the definitions in the framework. We believe it is more appropriate to fully address the definitions of liabilities and equity in the framework rather than transferring aspects to standard level projects.

**Question 4—Present obligation**

**Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?**

We agree that the definition of a present obligation should encompass more than just liabilities that are legally binding. We also agree with the concept that would identify “any obligation to transfer an economic resource that the entity has no practical ability to avoid” as a liability. Such a concept would give the most faithful representation, or best report the substance, of the obligation.

We recognise that there may be different perspectives on the concept of whether an entity has the “practical ability to avoid” and the concept may be different to those contained in current individual standards. However, we believe the definition is conceptually sound and any further assessment should be performed at standards level.

**Question 5—Other guidance on the elements**

**Do you have any comments on the proposed guidance?**

**Do you believe that additional guidance is needed? If so, please specify what that guidance should include.**

No further comments.

**Question 6—Recognition criteria**

**Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?**

We agree with the proposed recognition criteria of relevance and faithful representation. We also note that the cost versus benefit criterion is not a mechanism for preparers to avoid recognition but refers to the IASB’s assessment of benefits and costs.

**Question 7—Derecognition**

**Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?**

While we broadly agree with the proposed discussion of derecognition, we also believe the concepts could be simplified to be the reversal of the recognition criteria.

**Question 8—Measurement bases**

**Has the IASB:**

- (a) **correctly identified the measurement bases that should be described in the *Conceptual Framework*? If not, which measurement bases would you include and why?**
- (b) **properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?**

While we agree with the categories of measurement bases proposed, we believe emphasis should be given to the current value because it generally reflects the most relevant information. However, we do recognise that historic cost may be an appropriate measure at a standards level. We agree with Mr Finnegan's alternative view at AV28 that decisions regarding how to measure an asset or liability after initial recognition may have been derived from trying to deal with the concern about volatility in the reported profit and loss rather than whether the measure provides information with the qualitative characteristics desired in financial information.

**Question 9—Factors to consider when selecting a measurement basis**

**Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?**

No further comments.

**Question 10—More than one relevant measurement basis**

**Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?**

No further comments.

**Question 11—Objective and scope of financial statements and communication**

**Do you have any comments on the discussion of the objective and scope of financial statements, and on the use of presentation and disclosure as communication tools?**

No comment.

**Question 12—Description of the statement of profit or loss**

**Do you support the proposed description of the statement of profit or loss? Why or why not? If you think that the *Conceptual Framework* should provide a definition of profit or loss, please explain why it is necessary and provide your suggestion for that definition.**

We do not support the proposed description of the statement of profit or loss as it does not provide a conceptual basis for **how** the statement can be the primary source of information about an entity's financial performance. Furthermore, while the ED does not define profit or loss, it does state that income and expenses included in the statement of profit or loss are the primary source of information about an entity's financial performance. The proposed definitions of income and expenses in the ED align with the concept that movements in assets and liabilities drive income and expenses. This 'balance sheet' approach to the statement of profit or loss could be more clearly articulated in the framework. Furthermore, the basis for any exclusions from the profit and loss, such as those items currently reported in Other Comprehensive Income (OCI), is omitted from the ED.

We note the comments by the IASB in its Basis of Conclusions at paragraphs BC35—BC36. However, on the basis that the statement of profit or loss is reportedly the primary source of information about financial performance, we believe it is feasible to develop a definition of profit or loss.

**Question 13—Reporting items of income or expenses in other comprehensive income**

**Do you agree with the proposals on the use of other comprehensive income? Do you think that they provide useful guidance to the IASB for future decisions about the use of other comprehensive income? Why or why not? If you disagree, what alternative do you suggest and why?**

We do not agree with the proposals on the use of OCI as it excludes income and expenses from the profit or loss statement on the basis they relate to assets or liabilities measured at current values. This does not appear to be a valid distinction between those items that are currently reported in OCI or the profit or loss statement. Neither is the separation of income and expenses between elements judged to be realised or unrealised, recurring or non-recurring, controllable or non-controllable, volatile or non-volatile, or operational or non-operational.

We agree with the comment at paragraph BC7.34 – that income and expenses cannot be divided consistently into two categories in a manner that would provide useful information – because this is consistent with an entity's financial performance being multi-faceted. But one of the fundamental concepts proposed in the ED is that movements in assets and liabilities drive income and expenses, then it follows logically that all movements in assets and liabilities (excluding equity contributions and distributions) must be included in one single statement of financial performance. We encourage the IASB to shift its focus from one single measure of performance (ie profit) towards enabling users to understand and analyse the different aspects of an entity's performance.

**Question 14—Recycling**

**Do you agree that the *Conceptual Framework* should include the rebuttable presumption described above? Why or why not?**

**If you disagree, you propose instead and why?**

We do not support the concept of recycling as proposed in the ED because we believe the practice constitutes double counting of the same item of income or expense. However if recycling is to occur it should occur consistently for all items recognised in OCI. Recycling items would also need to be included in the elements.

**Question 15—Effects of the proposed changes to the Conceptual Framework**

**Do you agree with the analysis in paragraphs BCE.1–BCE.31? Should the IASB consider any other effects of the proposals in the Exposure Draft?**

We agree with the analysis in paragraphs BCE.1–BCE.31 and recognise the intention of the proposals is to provide a coherent basis for developing future standards, as opposed to eliminating existing inconsistencies.

**Question 16—Business activities**

**Do you agree with the proposed approach to business activities? Why or why not?**

No comment.

**Question 17—Long-term investment**

**Do you agree with the IASB's conclusions on long-term investment? Why or why not?**

No comment.

**Question 18—Other comments**

**Do you have comments on any other aspect of the Exposure Draft? Please indicate the specific paragraphs or group of paragraphs to which your comments relate (if applicable).**

No comment.

## **Appendix B: About Chartered Accountants Australia and New Zealand**

Chartered Accountants Australia and New Zealand is a professional body comprised of over 100,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members of Chartered Accountants Australia and New Zealand are known for professional integrity, principled judgment, financial discipline and a forward-looking approach to business. We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international capital markets.

We are represented on the Board of the International Federation of Accountants. Our global network also includes the 800,000-strong Global Accounting Alliance, and Chartered Accountants Worldwide, which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.