Department of Treasury and Finance

1 Treasury Place
GPO Box 4379
Melbourne Vic 3001
Australia
Telephone: (+61 3) 9651 5111
Facsimile: (+61 3) 9651 5298
DX 210759

Contact: Peter Gibson
Phone: 02 6215 3551

Mr Kevin Stevenson
Chairman
Australian Accounting Standard Board
PO Box 204
COLLINS ST WEST VIC 8007

Dear Mr Stevenson

ITC 29 *A review of the IASB's Conceptual Framework for Financial Reporting*

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Australian Accounting Standards Board (AASB) on ITC 29 *A review of the IASB's Conceptual Framework for Financial Reporting* ("the DP").

HoTARAC strongly supports the decision to resurrect the conceptual framework project. However, HoTARAC has significant concerns on the discussion in a number of areas.

HoTARAC does not believe the discussion of topics proceeds in a logical progression from a coherent set of core principles. In HoTARAC's view, this, at least in part, derives from:

- insufficient consideration of the objectives of financial reporting and their application to the topics at hand, and reliance on the existing chapters of the conceptual framework;
- delegation of core concepts, often fundamental to the topic discussed, to other projects; and
- the framework being developed to justify current practice, rather than from a sound conceptual basis.

The framework also appears to be developed in isolation from advances in related disciplines, such as communication, finance, economics and valuation with a consequent risk of loss of relevance.

Additionally, HoTARAC is concerned that the framework is being developed without consideration of the future direction of financial reporting, including the development of standards for the not-for-profit and public sectors. In HoTARAC's view, the framework could be substantially future proofed for these sectors through the simple expedient of using sector neutral language.

The Attachment to this letter sets out HoTARAC's views on the ITC. Any queries regarding HoTARAC's views and recommendations should be directed to Mr Peter Gibson from the Australian Department of Finance on 612 6215 3551 or by email to peter.gibson@finance.gov.au.

Yours sincerely

Steve Mitsas
on behalf of
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

21 November 2013

General Comments

HoTARAC welcomes the opportunity to provide comment on the IASB's discussion paper on the conceptual framework. HoTARAC believes the role of the framework is critical in providing consistency in the development of standards and strongly supports the decision to reinitiate this project and assign it a high priority. HoTARAC particularly welcomes the discussion on the conceptual basis for other comprehensive income, disclosures and materiality.

HoTARAC appreciates the lucidity of the language used in the discussion paper, making it easy to provide comments. HoTARAC also believes that the approach of using different teams to write each section, as a means of expediting development, has been useful, and could be considered again in future with projects of a similar nature. However, the natural consequence of this is that there are some inconsistencies between sections, for example paragraph 2.16(c) suggests a past event is not fundamental to the existence of a liability, while paragraph 3.65 indicates that a present obligation must have arisen from a past event, and there needs to be a final analysis for consistency as the discussion paper progresses towards an exposure draft.

HoTARAC believes that the framework should be a forward-looking, living document that develops a sound conceptual basis for the future development of standards. In HoTARAC's view, the discussion paper needs to undergo significant remedial work to achieve this.

HoTARAC is concerned that the objectives of financial statements have not been consistently applied and concepts not fully considered across the various sections of the discussion paper. In part, this may reflect the different authorship of the various sections, but also reflects the need for a more fundamental consideration of the objectives of financial statements. Critical to this is the setting of a clear, unambiguous objective for financial reporting to allow the lower level concepts to be developed logically. In HoTARAC's view, this has not been achieved and this should be a priority for the IASB in progressing the discussion paper towards an exposure draft.

HoTARAC also believes that elements of the discussion paper neglect, or omit altogether, consideration of core concepts which may resolve some of the issues raised. In particular, HoTARAC would note that there is very limited discussion on the entity versus proprietary perspective on financial reporting, which, for example, is fundamental to the discussions of Section 5 on equity.

This appears partially due to the decision to delegate key elements of the framework to the standard level (asset recognition criteria – paragraph 2.35(b)), research projects on current standards (disclosure – Section 7), response to previous exposure drafts (the reporting entity concept in Appendix B, which includes some discussion of the perspective from which financial reports are presented) or to future projects (capital maintenance discussed in paragraph 9.50). In order to meet the objective outlined in paragraph 1.25, in particular harmonisation, HoTARAC believes the framework should be a holistic set of core principles. Delegating conceptual issues to other projects is likely to result in a continuation of inconsistent decisions, voluminous disclosures and a lack of discipline in developing new standards.

HoTARAC would further contend that parts of the discussion paper attempt to reverse engineer current practice rather than advancing sound conceptual arguments. For example, the argument that internally generated goodwill and the value of the entity do not provide relevant information to users (paragraph 4.9c) would be surprising to investors who would consider this fundamental to their investment decisions. However, HoTARAC would accept that different accounting treatments of internally and externally generated goodwill may be justified on the basis of measurement reliability.

HoTARAC agrees with the decision to consider the International Integrated Reporting Council's (IIRC) work in developing an integrated reporting framework and the International Public Sector Accounting Standards Board (IPSASB) in developing a framework for the public sector. However, HoTARAC also believes the framework needs to consider developments in the wider areas of economics, finance, valuation, and communication. For example, development in communications would be relevant to presentation and the work of the International Valuations Standards Council (IVSC) in developing a framework for valuers would be relevant to the discussions on measurement.

Seeking to develop the framework in isolation from developments in other disciplines is short sighted and may lead to a loss of relevance for accounting information. Many entities present measures of performance alongside the measures of profitability mandated under accounting standards. Notwithstanding an element of opportunism, this reflects concerns that current measures of profitability do not reliably reflect the performance of the entity. Similarly, financial analysts as a matter of common practice reformulate financial statement information to provide information that they regard as more relevant to investors.

In light of the arguments outlined above, HoTARAC strongly recommends that the development of the framework should not necessarily be bound by previous decisions in the development of current IFRS or by the existing chapters of the conceptual framework. Accordingly, HoTARAC disagrees with the IASB's decision to not undertake a fundamental reconsideration of Chapters 1 and 3 of the Framework.

<u>Current Chapters of the Conceptual Framework</u>

In HoTARAC's view, the current chapters focus on a narrow group of users as potential resource providers and a narrow view of their interests as the future net cash flows of the entity. This has led to a lack of emphasis on stewardship and accountability. For example, a software company may accumulate a defensive patent portfolio to act as a strategic deterrent to competitors undertaking infringements suits. This will only contribute to future cash flows in an indirect manner, but may be indicative of the astute marshalling of the resources of the entity. However, there does not appear to be scope to demonstrate this within a conventional set of financial statements.

Similar to the impact of neglecting developments in other disciplines, the implicit assumption of Chapters 1 and 3 that users' needs are addressed solely through consideration of future cash flows, could potentially lead to the development of reports, such as performance reports in integrated reports, that meet these user needs and are consequently presented alongside, and to an extent compete with, the IFRS financial report. HoTARAC believes this indicates that a set of financial statements under IFRS does not cover a broad range of information needs.

HoTARAC also believes that the emphasis on future cash flows (paragraph OB4 of the existing IASB Conceptual Framework) has led to the development of unsound principles for applying different valuation techniques to assets depending on their contribution to future cash flows in Section 6. This also overlooks key strategic consideration for the holding of assets which are not necessarily related to future cash flows. For example, an entity may occupy a building with historical value, donate for charitable purposes or accumulate a defensive patent portfolio. None of these assets contribute to cash flows in any but the most indirect ways.

Not-for-profit sector

HoTARAC notes that IFRS development implicitly impact on financial reporting in the not-for-profit sector through a variety of mechanisms:

- The modification of IFRSs for application to the public sector by the IPSASB.
- The modification of the IFRS brand for adoption by the not-for-profit sector by domestic standard setters such as Australia.
- The application of concepts and principles promulgated through IFRS to not-for-profit entities in the United States through the convergence project with the FASB.

HoTARAC acknowledges that the current focus of the IASB is on developing high quality standards for the for-profit sector. However, the framework, by its nature, looks to the development of future standards which, in HoTARAC's view, should formally encompass the not-for-profit sector, including the public sector. This in part fulfils the current mandate of serving investors, as global capital markets are a source of funding for both private and public sectors and their efficient operation would benefit from increased transparency in reporting by the public sector. Past assumptions that government debt is risk free have been undermined by the Global Financial Crisis, demonstrating the need for a robust reporting framework for the public sector. HoTARAC believes that IFRS would provide the ideal basis for developing such a reporting framework. In this regard, HoTARAC notes that the IASB has also signed a Memorandum of Understanding with the IPSASB to strengthen cooperation on developing private and public sector accounting standards. HoTARAC hopes this will be the basis for future cooperation between the two bodies to develop a global set of standards for both profit and not-for-profit sectors.

In light of the current impact of IFRS on the not-for-profit sector, the stated purpose of the framework to assist national standard setters, which would include countries such as Australia that adopt the IFRS brand for the not-for-profit sector, and the IASB's commendable commitment to work with the IPSASB, HoTARAC strongly believes the IASB should address the not-for-profit sector at a future stage. In the interim, the language of the conceptual framework should be broad enough to encompass the not-for-profit sector. HoTARAC further recommends that this sector neutral language be considered in revisions to Chapters 1 and 3. The Australian experience[1] is this can be achieved with minimal effort.

1

http://www.aasb.gov.au/admin/file/content102/c3/M127_3.3_AASB_letter_IASB_AP14_Sept_2012_Restarting_the_CF_project_NFPs_final.pdf

Questions for respondents

HoTARAC has prepared responses to the propositions raised in the questions. HoTARAC's agreement or disagreement to a particular proposition does not necessarily imply support or opposition to all the matters raised in the discussion on that proposition.

> **Question 1**
> Paragraphs 1.25–1.33 set out the proposed purpose and status of the *Conceptual Framework*. The IASB's preliminary views are that:
> (a) 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; and
> (b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the *Conceptual Framework*. If this happens the IASB would describe the departure from the *Conceptual Framework*, and the reasons for that departure, in the Basis for Conclusions on that Standard.
> Do you agree with these preliminary views? Why or why not?

(a) HoTARAC agrees.
(b) HoTARAC agrees. However, where there is a difference with the conceptual framework, this suggests this may be an area for further investigation by the IASB and possible amendments to the framework. HoTARAC is of the view that the framework should be a living document, updated where necessary to reflect progression in accounting standard setting.

> **Question 2**
> The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:
> (a) an asset is a present economic resource controlled by the entity as a result of past events.
> (b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.
> (c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.
> Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

HoTARAC agrees with the proposed definitions. However, HoTARAC notes that by removing the notion of 'expected inflow of economic benefits' that underpins the current definition, the IASB is potentially encompassing a far wider range of assets. In combination with the comment in question 8 that an entity should recognise all its assets and liabilities, unless the IASB decides when developing a particular standard that an entity need or should not recognise as asset/liability, this will potentially increase the workload for entities.

Paragraph 2.16(c) states:

> "retain, in both definitions, the phrase 'as a result of past events'. This emphasises the accounting for the past transaction or other event that brought the resource under the entity's control or imposed the obligation on the entity. It is not necessary to identify that event in order to identify whether the entity has an asset or a liability. Nevertheless, by identifying that event, an entity can determine how best to portray that event in its financial

statements, for example, how best to classify and present income, expenses or cash flows arising from that event."

This suggests a 'past event' is not fundamental to the definition, but indicative of how best it be accounted for in the financial statement. However, paragraph 3.65 and Tables 3.2 and 3.3 suggests a past event is a necessary condition for a present obligation (and hence a liability); paragraph 3.67 hints it may be a sufficient condition. HoTARAC recommends this be clarified.

Question 3
Whether uncertainty should play any role in the definitions of an asset and a liability, and in the recognition criteria for assets and liabilities, is discussed in paragraphs 2.17–2.36. The IASB's preliminary views are that:
(a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'. An asset must be capable of producing economic benefits. A liability must be capable of resulting in a transfer of economic resources.
(b) the *Conceptual Framework* should not set a probability threshold for the rare cases in which it is uncertain whether an asset or a liability exists. If there could be significant uncertainty about whether a particular type of asset or liability exists, the IASB would decide how to deal with that uncertainty when it develops or revises a Standard on that type of asset or liability.
(c) the recognition criteria should not retain the existing reference to probability. Do you agree? Why or why not? If you do not agree, what do you suggest, and why?

(a) HoTARAC tentatively agrees. However, HoTARAC is of the view that uncertainty needs to be addressed only in the recognition criteria. This is consistent with the IASB's view that an item that would meet the definition of an asset or liability should not automatically be recognised.

(b) HoTARAC does not agree. The proposal in the text that:
"2.15 In existing practice, some of the economic resources identified in paragraph 2.14 are not typically recognised as assets. The recognition criteria in the relevant Standard would determine whether an entity recognises those assets (see Section 4)."

and that:

> "2.35 (b) 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. The IASB would also consider how an entity would provide the most faithful representation of the circumstances, and how an entity would make the information provided more comparable, verifiable, timely and understandable."

assumes that there is, or will be, an accounting standard to cover every possible scenario. This would lead to an unnecessary proliferation of standards. HoTARAC would strongly recommend that the boundaries for assets and liabilities be addressed in the conceptual framework, as delegating this to standard level will again lead to inconsistencies the framework aims to address. Accordingly, HoTARAC suggests that probability be retained in the recognition criteria of assets and liabilities. If probability is retained for existence uncertainty, HoTARAC suggests an equivalent threshold of probable for both assets and liabilities, i.e. an asset/liability probably exists.

(c) As stated above, HoTARAC believes that probability needs to be retained as a factor in the recognition criteria to ensure assets and liabilities that are unlikely to bring economic benefits to the entity are excluded from recognition to minimise any measurement uncertainties subsequent to the initial recognition. HoTARAC notes that the type of asset has not been considered in determining appropriate recognition criteria. HoTARAC agrees where a market price is frequently available or well developed algorithms have been developed for calculating value, such as for most financial instruments, a probability threshold should not be used to inappropriately exclude assets such as options. In these instances, it is appropriate to conclude an asset or liability is probable at the relevant measurement of the asset or liability. However, for assets that are not financial assets such as patents and research and development with nebulous benefits the application of a probability filter may be necessary. For example, a biotech company may be working on a cure for cancer with potentially huge benefits should they be successful. It is doubtful whether multiplying their estimated chance of success by their estimated pay off would provide a meaningful figure or more reliable information than relevant note disclosure.

HoTARAC notes that the Section 6 on measurement suggests that measurement phase be contingent on assessment of the asset or liability (paragraph 6.16). HoTARAC does agree with this approach, as outlined in the response to question 11. In HoTARAC's view this idea has merit, but should be considered in relation to the recognition criteria, in preference to promoting inconsistency in measurement.

HoTARAC further suggests in the response to question 24 that the unit of account be considered in relation to recognition criteria.

Question 4

Elements for the statement(s) of profit or loss and OCI (income and expense), statement of cash flows (cash receipts and cash payments) and statement of changes in equity (contributions to equity, distributions of equity and transfers between classes of equity) are briefly discussed in paragraphs 2.37–2.52.

Do you have any comments on these items? Would it be helpful for the *Conceptual Framework* to identify them as elements of financial statements?

HoTARAC disagrees with the decision not to differentiate gain and losses from revenue and expenses. The existing Conceptual Framework defines 'income' and 'expense', however the relationships between different concepts i.e. 'income', 'revenue' and 'gain', and 'expense' and 'loss', have never been clearly explained. Although HoTARAC agrees with the opening sentence that if distinguishing between these items is useful, they should be defined as separate elements, HoTARAC does not see how this process will be less problematic if delegated to the standard level as suggested in the second last sentence of paragraph 2.46.

Similarly, HoTARAC disagrees with the decision not to distinguish items reported in profit and loss from those reported in OCI (paragraph 2.49). HoTARAC notes that Section 8 of the Discussion Paper provides some guidance about which items should be included in profit and loss and which in OCI and also understands the difficulties in explicitly differentiating these items in the Conceptual Framework. However, HoTARAC is of the view that as for profit and loss, OCI also contains relevant information for the assessment of an entity's overall performance. On that basis, some high level principles would be preferred in the Conceptual Framework to ensure that the classification of items in profit and loss vs OCI is applied in a systematic and consistent manner.

In addition, as mentioned in the general comments, the framework should not be reverse engineered to justify existing decisions made with respect to items included in OCI under existing standards. HoTARAC considers the goal of consistency should extend to items included in OCI. Exception to the principles could then be considered at the standard level as envisaged in question 1(b).

Question 5
Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.
Do you agree with this preliminary view? Why or why not?

HoTARAC agrees. In HoTARAC's view the definition of a liability needs to be broader than just legal obligations to prevent obligations being inappropriately excluded from the balance sheet on the basis of legal form.

Question 6
The meaning of 'present' in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity's future actions. Three different views on which the IASB could develop guidance for the *Conceptual Framework* are put forward:
(a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.
(b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.
(c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity's future actions.
The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3.
Which of these views (or any other view on when a present obligation comes into existence) do you support? Please give reasons.

HoTARAC supports View 2. HoTARAC believes that View 3 is too broad and will make it difficult for preparers and auditors to distinguish between liabilities and commitments. Notwithstanding the discussion on executory contracts, it is quite plausible that many forms of agreement not currently recognised as liabilities could satisfy this broader criteria. The threshold of 'practical ability to avoid' is a useful boundary to apply and prevents the recognition of unnecessary assets and liabilities that do not provide useful information to users. For example, would an employment contract lead to recognition of a liability for future year service under View 3?

Question 7
Do you have comments on any of the other guidance proposed in this section to support the asset and liability definitions?

HoTARAC has no further comments.

Question 8
Paragraphs 4.1–4.27 discuss recognition criteria. In the IASB's preliminary view, an entity should recognise all its assets and liabilities, unless the IASB decides when developing or revising a particular Standard that an entity need not, or should not, recognise an asset or a liability because:
(a) recognising the asset (or the liability) would provide users of financial statements with information that is not relevant, or is not sufficiently relevant to justify the cost; or
(b) no measure of the asset (or the liability) would result in a faithful representation of both the asset (or the liability) and the changes in the asset (or the liability), even if all necessary descriptions and explanations are disclosed.
Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

HoTARAC agrees, but notes the conceptual framework also proposes delegating recognition criteria to the standard level. HoTARAC further notes that without relevant recognition criteria, this could result in a broader range of assets being recognised than would be expected under the current framework. HoTARAC also believes that delegating recognition criteria to the standard level may foster inconsistencies between individual standards. HoTARAC therefore prefers that individual standards only contain exceptions to the general recognition principles (the latter should ideally be included in the framework).

Question 9
In the IASB's preliminary view, as set out in paragraphs 4.28–4.51, an entity should derecognise an asset or a liability when it no longer meets the recognition criteria.
(This is the control approach described in paragraph 4.36(a)). However, 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. Possible approaches include:
(a) enhanced disclosure;
(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; or
(c) continuing to recognise the original asset or liability and treating the proceeds received or paid for the transfer as a loan received or granted.
Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

HoTARAC agrees with using Approach (b). In HoTARAC's view, retaining the rights and obligations in the statements would faithfully reflect the substance of the transactions and provide more relevant information to users of financial information. In HoTARAC's opinion, note disclosure should not be substituted for the recognition of elements in the financial statements.

Question 10
The definition of equity, the measurement and presentation of different classes of equity, and how to distinguish liabilities from equity instruments are discussed in paragraphs 5.1–5.59. In the IASB's preliminary view:
(a) the *Conceptual Framework* should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.
(b) the *Conceptual Framework* should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments. Two consequences of this are:
(i) obligations to issue equity instruments are not liabilities; and
(ii) obligations that will arise only on liquidation of the reporting entity are not liabilities (see paragraph 3.89(a)).
(c) an entity should:
(i) at the end of each reporting period update the measure of each class of equity claim. The IASB would determine when developing or revising particular Standards whether that measure would be a direct measure, or an allocation of total equity.
(ii) recognise updates to those measures in the statement of changes in equity as a transfer of wealth between classes of equity claim.
(d) 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, with suitable disclosure. 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.
Do you agree? Why or why not? If you do not agree, what changes do you suggest, and why?

(a) HoTARAC agrees. However, HoTARAC would also prefer to have more principles in the framework for the individual components of equity.
(b) HoTARAC agrees.
(c) HoTARAC disagrees. This seems incompatible with the stated objective of financial statements to provide information about future cash flows.
(d) HoTARAC disagrees. Although the proposal appears to be consistent with the existing definition of equity, which is defined as a residual, classifying the next "closest" debt instrument as equity would further blur the distinction between liabilities and equity. If no equity has been issued, HoTARAC does not consider it necessary to designate a debt instrument as equity. However, HoTARAC believes it is essential to articulate the nature and characteristics of equity items in the definition in order to ensure that equity definition could be applied consistently.

Question 11
How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB's preliminary views are that:
(a) the objective of measurement is to contribute to the faithful representation of relevant information about:
(i) the resources of the entity, claims against the entity and changes in resources and claims; and
(ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.
(b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
(c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;
(d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
(i) for a particular asset should depend on how that asset contributes to future cash flows; and
(ii) for a particular liability should depend on how the entity will settle or fulfil that liability.
(e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and
(f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.
Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

(a) HoTARAC agrees, but does not believe this can be achieved by only looking at the cash flows associated with the asset or liability. As noted in the general comments, it is extremely difficult to progress the discussion on measurement without further consideration of the objectives of financial reporting and discussion of core concepts, such as the equity vs proprietary perspective and the use of the business model. The absence of consideration of these core principles leads to assertions that have little or no conceptual justification, such as the statements on the relevance of the cost and current price measurement bases assets depending on whether they directly generate cash flows.

(b) HoTARAC does not agree. HoTARAC accepts that no single measurement base is likely to be ideal in all circumstances because no single measurement base will score highly on all elements of the faithful representation characteristics while meeting the cost benefit criteria of part (f) of the question. However, HoTARAC strongly believes the conceptual framework should move towards a preferred base. HoTARAC accepts that the preferred base will not be appropriate in all circumstances for reasons of relevance/usefulness or, in particular, where the costs of using the preferred base outweigh the benefits (for example, it is unlikely the benefits of measuring inventory at fair value would justify the cost in most circumstances). Nonetheless, having a preferred base accords with the overall goal of improving consistency by promoting a consistent measurement base. As the other items in the financial statements are driven by movements in assets and liabilities, consistency is important for the production of meaningful financial aggregates.

HoTARAC is not unsympathetic to the view that assets have different uses and this should be reflected in the financial statements, however HoTARAC believes that such differentiation is more appropriately applied to recognition criteria.

HoTARAC believes the statement of paragraph 6.13(b) that users find cost-based information for property, plant and equipment used in production should be justified.

(c) Agree.

(d) HoTARAC disagrees. In addition to compromising the integrity of financial aggregates mentioned above, the assumption that the sole purpose of holding assets is the generation of cash flow is too narrowly focused to be appropriate for all entities that may apply IFRS. It also may not be consistent with the proposal to integrate the 'business model' concept into the Conceptual Framework. HoTARAC strongly suggests the conceptual framework work towards a preferred measurement base, while accepting that alternative measurement bases may be appropriate in different circumstances.

(e) Agree.

(f) Agree.

Question 12
The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:
(a) 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.
(b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.
(c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.
(d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.
Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach
you would support.

(a) HoTARAC disagrees. If a reliable market price is available, it is difficult to see why this is not at least as relevant as a cost based measure. This information would also be valuable in the event the asset required replacement. Revaluation adjustments could be channelled through OCI, ensuring the income statement is not distorted by irrelevant changes in fair value.

(b) HoTARAC agrees.

(c) HoTARAC agrees, but does not see this as necessarily more so than fair value.

(d) HoTARAC partially agrees. In HoTARAC's view it is preferable to have a consistent measurement base, but agrees that, for example, where there are large groups of low value charge-for-use items, cost based measurements may be appropriate.

Question 13
The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:
(a) cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.
(b) a cost-based measurement will normally provide the most relevant information about:
(i) liabilities that will be settled according to their terms; and
(ii) contractual obligations for services (performance obligations).
(c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.
Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

(a) HoTARAC agrees. However, the framework should acknowledge that there may be circumstances where a fair value measurement is possible.
(b)(i),(ii) HoTARAC also believes that income base methods (looking at the cash outflows associated with the liability) would be at least as appropriate.
(c) HoTARAC is unsure about the intention of this proposal, whether the intention is that only transferable liabilities should be measured using current market prices (in practice, it is likely that few liabilities could be freely transferred between entities). If that is the intention, HoTARAC questions whether some of the measurement principles for liabilities under IFRS 13, such as the hypothetical transfer notion would become redundant. HoTARAC also believes the framework should provide guidance on the use of cash-flow based measures where there is uncertainty over the timing and amount of cash flows.

Question 14
Paragraph 6.19 of the DP states the IASB's preliminary view that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. For example, cost-based information about financial assets that are held for collection or financial liabilities that are settled according to their terms may not provide information that is useful when assessing prospects for future cash flows:
(a) if the ultimate cash flows are not closely linked to the original cost;
(b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets or financial liabilities; or
(c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (i.e. the asset or the liability is highly leveraged).
Do you agree with this preliminary view? Why or why not?

HoTARAC agrees. HoTARAC believes that current market price is most relevant where this is available.

Question 15
Do you have any further comments on the discussion of measurement in this section?

HoTARAC has no further comments.

Question 16
This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the *Conceptual Framework*. In developing its preliminary views, the IASB has been influenced by two main factors:
(a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and
(b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:
(i) a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;
(ii) amendments to IAS 1; and
(iii) additional guidance or education material on materiality.
Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on:
(a) presentation in the primary financial statements, including:
(i) what the primary financial statements are;
(ii) the objective of primary financial statements;
(iii) classification and aggregation;
(iv) offsetting; and
(v) the relationship between primary financial statements.
(b) disclosure in the notes to the financial statements, including:
(i) the objective of the notes to the financial statements; and
(ii) the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking information and comparative information.
Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the *Conceptual Framework*.

HoTARAC agrees, but is concerned that key elements of the conceptual framework could be delegated to the research project on IAS 1, IAS 7 and IAS 8. The revision of the framework represents a rare opportunity to promote consistency in standard setting and addresses the increased voluminousness of disclosures. HoTARAC would strongly suggest these projects be incorporated into the conceptual framework, rather than a parallel project as suggested in paragraph 7.7, to avoid the problems of inconsistency and excessive disclosure that plague current IFRS.

HoTARAC would also question why presentation has been prioritised for a research project. In HoTARAC's view, there are several aspects of the discussion paper that would benefit from further research, in particular the objective of financial statements which underpin the framework.

Question 17
Paragraph 7.45 describes the IASB's preliminary view that the concept of materiality is clearly described in the existing *Conceptual Framework*. Consequently, the IASB does not propose to amend, or add to, the guidance in the *Conceptual Framework* on materiality.
However, the IASB is considering developing additional guidance or education material on materiality outside of the *Conceptual Framework* project.
Do you agree with this approach? Why or why not?

HoTARAC agrees that additional guidance would be useful. However, HoTARAC questions why this should not be included in the framework as it will be clearly useful to preparers.

Question 18
The form of disclosure requirements, including the IASB's preliminary view that it should consider the communication principles in paragraph 7.50 when it develops or amends disclosure guidance in IFRSs, is discussed in paragraphs 7.48–7.52.
Do you agree that communication principles should be part of the *Conceptual Framework*?
Why or why not?
If you agree they should be included, do you agree with the communication principles proposed?
Why or why not?

HoTARAC agrees.

Question 19
The IASB's preliminary view that the *Conceptual Framework* should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.
Do you agree? Why or why not?
If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

HoTARAC agrees. HoTARAC does not believe this should be delegated to the standard level.

Question 20
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 be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.
Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?
If you do not agree, how would you address cash flow hedge accounting?

HoTARAC agrees that some items presented in OCI should be recycled. HoTARAC does not agree that all items should be recycled through to profit and loss. In HoTARAC's view, a transaction represents an economic event that is recognised in the financial statements and should not be represented unless the trigger point represents the inflow of economic benefits to the entity.

HoTARAC would strongly urge the IASB to develop clear principles for:

- when an item should be presented in profit and loss and when it should be presented in OCI; and
- when an item should be recycled from OCI into profit and loss, e.g. should realisation of the asset or settlement of the liability be the only trigger for recycling?

While these may not necessarily be consistent with current practice, articulating a clear set of principles is critical that the use of OCI is developed in a logical way. In that respect, identification of high level principles and those triggering events to the extent possible in the Conceptual Framework would facilitate a consistent application of the recycling rules from OCI to profit and loss.

HoTARAC disagrees with paragraph 1.29, that some aspects are intended only for use by the IASB in IFRS development. HoTARAC has particular concerns over citing the example of OCI as this suggests a lack of sound conceptual basis for distinguishing items between items in OCI and profit and loss.

Question 21
In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).
Which of these approaches do you support, and why?
If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

HoTARAC's preference is Approach 2B as it agrees with paragraph 8.79 that some items such as defined benefit movements and revaluation adjustments should be included in OCI and it is difficult to see the justification for recycling all items through to profit and loss unless this provides relevant information. The profit and loss and OCI represent different measurement bases and should be used consistently. HoTARAC is of the view that if the IASB could further clarify the objective of profit or loss and OCI in the Conceptual Framework, it would be much easier to determine which items of OCI should be recycled into profit or loss and when that recycling should take place.

HoTARAC also believes further research should be undertaken on whether a consistent approach can be adopted for such decisions. For example, it may be necessary to add another category for items which are outside the control of the entity. HoTARAC considers this category could potentially encompass mismatched remeasurements and the 'transitory remeasurements' of paragraph 8.89. HoTARAC acknowledges this is considered in table 8.1 and rejected on the basis that management chooses what risks it is exposed to. However, it is difficult to see what influence management can have over mismatched remeasurement and transitory requirements, so it may be possible to include this as a more narrow category for inclusion in OCI.

HoTARAC also questions the need for 'bridging items' and the circumstances in which different measurement bases are required. HoTARAC notes that the use of a preferred measurement base, as HoTARAC recommends, would minimise the need for bridging items. HoTARAC agrees with paragraph 8.61 that bridging items should be automatically recycled.

HoTARAC disagrees with paragraph 8.10 that the framework not address whether OCI and profit and loss should be presented as a single statement or two separate statements. In HoTARAC's view, this is a fundamental distinction that should be made in the framework. HoTARAC supports a single statement and believes this should be part of a broader consideration of the use of OCI. HoTARAC further suggests that the need for recycling may arise because items in OCI are assigned a lesser importance and further consideration should be given to whether this can be addressed through presentation.

Question 22

Chapters 1 and 3 of the existing Conceptual Framework Paragraphs 9.2–9.22 address the chapters of the existing *Conceptual Framework* that were published in 2010 and how those chapters treat the concepts of stewardship, reliability and prudence. The IASB will make changes to those chapters if work on the rest of the *Conceptual Framework* highlights areas that need clarifying or amending. However, the IASB does not intend to fundamentally reconsider the content of those chapters.
Do you agree with this approach? Please explain your reasons.
If you believe that the IASB should consider changes to those chapters (including how those chapters treat the concepts of stewardship, reliability and prudence), please explain those changes and the reasons for them, and please explain as precisely as possible how they would affect the rest of the *Conceptual Framework*.

HoTARAC disagrees. As discussed in the general comments, HoTARAC believes that the framework should be a living document geared to future development of accounting standards. Consideration of the existing framework is fundamental to this process. Additionally, HoTARAC considers that Chapters 1 and 3 of the current framework are unnecessarily restrictive and reflects a focus on a narrow group of financial report users. Broader consideration of users groups and their needs would allow the IASB to consider, in addition to for-profit sector issues, whether financial reports enable users to assess an entity's performance, management and resource allocation decisions regardless of whether it's a government or a public sector entity.

In HoTARAC's view, as previously expressed to the IASB in the response to the 2010 Exposure Draft, Chapters 1 and 3 of the Framework do not place sufficient emphasis on stewardship and accountability, and hence appear somewhat inconsistent with the work of the International Integrated Reporting Council (IIRC), which puts specific emphasis on corporate responsibility, stewardship and business sustainability and in which financial information should form a subset that would share some visions and objectives of the integrated reporting framework.

Question 23
Business model
The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB's preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.
Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?
If you agree, in which areas do you think that the business model concept would be helpful?
Should the IASB define 'business model'? Why or why not?
If you think that 'business model' should be defined, how would you define it?

Although HoTARAC agrees that the business model concept could play a role in financial reporting, this cannot be discussed without some consideration of the objectives of financial statements.

In HoTARAC's view, if financial statements have the objective of providing information specific to the entity, then the only information that is relevant is business specific information and this overrides the need for consistency in reporting transactions of a similar nature across entities.

However, if financial statements have a different objective, the use of the business model concept in isolation would inappropriately promote inconsistency in the reporting of transactions between entities. In HoTARAC's view, it would be more appropriate to address the nature of the transaction. That is, for financial reporting purposes, the accounting treatment should always reflect the substance of the transaction rather than a pure reflection of the business model of a particular entity. Identical transactions shall be treated in similar ways irrespective of whether the entity is for-profit or not-for-profit. For example, is the transaction conducted for commercial reasons or a not-for-profit reason, such as a donation? HoTARAC believes this emphasises the importance of the eventual consideration of transactions for both the for profit and not-for-profit sectors.

The Conceptual Framework needs to be explicit about when and how the business model concept should be incorporated into specific standard(s) and how such a concept should be consistently applied in practice.

Question 24
Unit of account
The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.
Do you agree? Why or why not?

HoTARAC agrees that the unit of account should be based on the qualitative characteristics of useful financial information. However, HoTARAC notes that the unit account is critical to the notions of recognition, capital consumption through depreciation and measurement and should be addressed, where possible, at the conceptual level. At a minimum, HoTARAC suggests that the framework require the unit of account to be explicitly addressed when each standard is developed.

HoTARAC notes this has particular relevance to the probability threshold applying to asset recognition. HoTARAC recommends the discussion on recognition and measurement criteria include discussion of the unit of account.

Question 25
Going concern
Going concern is discussed in paragraphs 9.42–9.44. The IASB has identified three situations in which the going concern assumption is relevant (when measuring assets and liabilities, when identifying liabilities and when disclosing information about the entity).
Are there any other situations where the going concern assumption might be relevant?

HoTARAC is not aware of any.

Question 26
Capital maintenance
Capital maintenance is discussed in paragraphs 9.45–9.54. The IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.
Do you agree? Why or why not? Please explain your reasons.

HoTARAC does view the concept of capital maintenance as critical to the development of the framework and notes no widely accepted concept applies at present. However, HoTARAC would question whether elements of physical capital maintenance have been introduced into the discussion on measurement being contingent on whether an asset is used in production.

Other Comments:

HoTARAC disagrees that the reporting entity should not be discussed as part of the development of the framework (paragraph B3). In HoTARAC's opinion the interaction between the framework, particularly Chapters 1 and 3 which discuss user needs, and the perspective from which financial reports should be presented (discussed in paragraph B12) make this an important area for discussion.

AASB Specific Matters for Comment:

1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views, particularly any issues relating to:
   (a) not-for-profit entities; and
   (b) public sector entities, including the implications of the preliminary views for GAAP/GFS harmonisation;
2. whether, overall, the preliminary views would result in financial statements that would be useful to users;
3. whether the preliminary views are in the best interests of the Australian economy; and
4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the preliminary views relative to the current treatments, whether quantitative (financial or non-financial) or qualitative.

1. HoTARAC is not aware of any regulatory issues for public sector entities. HoTARAC cannot comment on other not-for-profit entities.

   The framework considers a wide range of topics that may impact on GAAP/GFS harmonisation. HoTARAC notes that the proposals that measurement be contingent on the use of the asset and the preference for cost-based measures in some circumstances would be incompatible with current GFS harmonisation requirements to use the fair value option in existing standards when compiling harmonised statements. Similarly, the definition of constructive obligations would impact on harmonisation as these are not recognised under GFS. Finally, there is a presentation issue of the concept of OCI adopted as this will impact on the reconciliation of the operating result to the GFS aggregates.

2. HoTARAC believes that a conceptual framework would result in financial statements useful to users. However, HoTARAC would also note that the revised framework, when completed, potentially has wide ranging implications for financial reporting in Australia. HoTARAC would specifically note that the asset definitions have the potential to create confusion as to what constitutes an asset and the circumstances in which these are recognised and that the eventual definition of constructive obligations will have a significant impact on the recognition of liabilities on the balance sheet.

   The AASB intends to develop guidance for the not-for-profit sector for incorporation into the AASB conceptual framework when that is based on the eventual outcomes of the IASB's conceptual framework. HoTARAC recommends the AASB also undertake a domestic project to assess the wider impact of the revised framework, including the implications for GAAP/GFS harmonisation, as it progresses toward completion. This in turn would complement the development process of not-for-profit guidance for the conceptual framework.

3. No comments.

4. HoTARAC's views are outlined in the response to the IASB and the AASB specific matters for comment and has no further comment.