

The Institute of Public Accountants



IPA INSTITUTE OF PUBLIC
ACCOUNTANTS®

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The Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir

Exposure Draft 2015/3 Conceptual Framework for Financial Reporting

Thank you for the opportunity to comment on Exposure Draft 2015/3 “Conceptual Framework for Financial Reporting” and Exposure Draft 2015/4 “Updating References to the Conceptual Framework”.

The IPA supports the efforts to update the Conceptual Framework (CP), however the IPA believes there are a number of areas where the extent of the proposed changes need to be addressed or alternatively added to the CP. The CP should address the following:

Role of the Conceptual Framework

While paragraphs IN1 and IN5 provide some context to the role of the CP, the IPA believes there needs to be a stronger emphasis on the impact of the CP on the IASB’s standard setting process, including under which circumstances the IASB will depart from the CP and how this is to be documented.

Similarly, IAS 1 needs to explicitly acknowledge the status of the CP in the hierarchy when selecting accounting standards and no existing standards cover the circumstances.

Finally, the IASB needs to raise the profile of the CP to ensure preparers understand the role of the CP and when to apply it.

Going Concern

The IPA considers the way going concern is addressed in the CP as rudimentary at best. Ideally, going concern should be consistent with the concept as articulated in the auditing standards.

Furthermore, the responsibility of management and Those Charged with Governance (TCWG) for deciding on the application of the going concern assumption should be clearly articulated in the CP.

Risk

The CP is virtually silent on risk. The IPA believes an understanding of the risk of the business activities is critical to understanding the financial performance. Return needs to be assessed in terms of the risk profile of the business activities as does management’s performance.

In addition, management’s policies and procedures for mitigating risks is important to assess the risk to both investors’ funds and the variability of returns.

Management Commentary

The IPA believes management discussion and analysis (MDA) is a critical component in the financial reporting process. The proposed update to the CP only touches on non-quantitative aspects of financial reporting and the IPA would like to see this enhanced in the CP.

Management and Investment Performance

The IPA is of the view that one of the principle purposes of financial reporting is to assess the performance of management in obtaining returns and safeguarding invested funds. The other objective in relation to the reporting of performance is the assessment of management's remuneration. The proposed revisions to the stewardship concept do not strongly reflect these objectives.

Alternative Performance Measures

Another issue not addressed in the CP is the status of alternative performance measures (APM). The IPA believes the CP should articulate why performance measured in accordance with IFRS are superior to APM.

Capital Management

The IPA believes the proposed draft of the CP does not adequately address capital management issues, particularly in the context of risk management. The IPA would like the CP to address capital management concepts, including the assessment of appropriate capital levels and economic returns.

Transition Implementation Group

While the Transition Implementation Group fulfils a useful role in the implementation of the new standard, it should not be seen as further due process in the development of the standard and as such effectively re-expose the standard for comment and amendment.

The IPA is of the view that after appropriate due process, standards should be allowed to be implemented and further "tinkering" should be avoided; rather, standards should be allowed to be "bedded down" and practices emerge. Only at such time should amendments be considered either through the IFRIC process in relation to urgent and substantive matters or through a proper post implementation review of the standard.

The IPA has no substantive comments on ED 2015/4. Our comments and responses to the questions in the Exposure Draft ED 2015/3 are set out in Appendix A.

If you would like to discuss our comments, please contact me or our technical advisers Mr Stephen La Greca (stephenlagreca@aol.com) or Mr Colin Parker (colin@gaap.com.au) (a former member of the AASB), GAAP Consulting.

Yours faithfully



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Cc Ms K Peach – Australian Accounting Standards Board

About the IPA

The IPA is a professional organisation for accountants recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 35,000 members in Australia and in over 65 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice. Through representation on special interest groups, the IPA ensures the views of its members are voiced with government and key industry sectors and makes representations to Government including the Australian Tax Office (ATO), Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) on issues affecting our members, the profession and the public interest. The IPA recently merged with the Institute of Financial Accountants of the UK, making the new IPA Group the largest accounting body in the SMP/SME sector in the world.

Appendix A: Exposure Draft 2015/3

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?

IPA Response

(a) Stewardship

While the IPA supports the prominence given to stewardship in the Conceptual Framework (CP), the IPA believes the importance of stewardship as the objective of financial reporting warrants more detail. In the IPA’s opinion, financial reporting is primarily an accounting of management’s performance in managing the funds provided by investors, including the safeguarding of those funds by the application of appropriate risk management techniques and the generation of economic returns.

Meaningful accounting for management’s activities is critical to counterbalancing the “agency problem” and should also provide input into management remuneration and tenure.

Stewardship as defined in the CP should specifically address management’s:

- Safeguarding the investors’ funds and reporting entity assets
- Selection and application of risk management techniques, and
- The earning of economic returns.

(b) Prudence

The IPA does not support the reintroduction of the concept of prudence. The IPA believes prudence will be interpreted as conservatism which will encourage overstatement of provisions, deferral of income and other techniques undertaken by management to “smooth” results. Rather the IPA believes the emphasis should be on neutrality and the elimination of management bias.

(c) Faithful Representation

The IPA supports the inclusion of faithful representation in the CP.

(d) Measurement Uncertainty

The IPA agrees with measurement uncertainty being included as an aspect of relevance. The IPA is of the view the level of measurement uncertainty does not necessarily make the recognition or measurement of a balance or transaction less relevant. However, where recognition or measurement is subject to measurement uncertainty additional information relating to the uncertainty needs to be provided rather than excluding the balance or transaction.

(e) Relevance and Faithful Representation

The IPA supports the continued inclusion of relevance and faithful representation as two of the fundamental 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?

IPA Response

The IPA believes the definition of reporting entity is inadequate as it does not clearly set out the characteristics of a reporting entity. The definition of reporting in 3.11 as an entity that chooses to or is required to prepare general purpose financial statements as such is deficient and self-referential.

The IPA agrees that legal entity is not necessarily the reporting entity.

The IPA does not agree that consolidated financial statements are always most likely to provide the most useful information to users of the financial statements. Parent company financial statements may be more appropriate when assessing going concern, liquidity or the capacity to pay dividends.

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?

IPA Response

The IPA broadly supports the definitions of assets, economic resources, income and expenses. However, while understanding there is a separate project relating to the financial instruments with the characteristics of equity, the IPA has reservations in relation to the definitions of liabilities and equity in the CP.

In relation to equity, the IPA is of the view that one of the critical characteristics of equity is its loss absorption nature and this characteristic should be a component of any definition of equity.

The IPA also has two further reservations in relation to the definition of liabilities:

- Paragraph 4.3 of the CP appears to be inconsistent with the IAS 32 “Presentation of Financial Instruments” principles in relation to the classification of equity and liabilities, and
- The revised CP extends the concept of “no practical ability to avoid the transfer” to introduce an economic compulsion test to determine the existence of a liability. The IPA believes this is also inconsistent with the principles in IAS 32. BC4.65 of the CP noted that in determining the definition of a liability, the IASB considered IFRIC 21 “Levies”, however the IPA believes the conceptual underpinning of IFRIC 21 is flawed and the proposed amendments to the CP simply compound that flaw.

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?

IPA Response

While the IPA broadly supports the proposed description of a present obligation, as indicated in the response to question 3, the IPA has concerns in relation to the introduction of the economic compulsion test.

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.

IPA Response

The IPA has 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?

IPA Response

The IPA generally supports the proposed recognition criteria, however the IPA is concerned with the inclusion of a cost benefit test as a recognition criteria. The IPA believes the concept of materiality provides a more conceptually sound basis for the decision to recognise an asset or liability.

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?

IPA Response

The IPA agrees with proposed discussion of derecognition.

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?*

IPA Response

The IPA broadly agrees with the measurement basis described in CP.

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?

IPA Response

The IPA supports the proposed guidance on selecting a measurement basis.

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?

IPA Response

The IPA supports the guidance on using more than one relevant measurement basis.

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?

IPA Response

While the IPA supports the proposed guidance in the CP, the IPA is of the opinion the objective and scope set out in the guidance is too narrow. The IPA considers the scope of financial statements and

communication should include management discussion and analysis supporting the quantitative disclosures; and the current proposals do not put sufficient emphasis on this aspect of financial reporting.

In addition, the current scope does not consider qualitative factors for the risks in relation to the reporting entity's business nor the steps (or absence thereof) management has taken to respond to those risks.

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.

IPA Response

As previously indicated, the IPA is of the view that one of the principal objectives of financial reporting is to assess management's performance in generating economic returns for investors and, as such, the statement of profit and loss is a key document in that assessment.

The IPA believes the current approach to reporting financial performance is not definitive and does not provide sufficient guidance on what quantitative measures should be preferably used in assessing financial performance.

The IASB needs to include in the CP a robust model based on a strong conceptual basis. The basis for developing the model should be reflective of the underlying business of the reporting entity. The model must clearly articulate the reasons for supporting the performance measures selected and why the selected performance measures are preferable to alternative performance measures.

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?

IPA Response

The IPA does not support the rebuttable assumption that all income and expenses as defined in the CP should be included in profit and loss. As stated above, the IPA is of the opinion the profit and loss should recognise income and expense consistent with the reporting entity's business model, other items of income and expense should be recognised in other comprehensive income.

Question 14 – Recycling

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

If you disagree, what do you propose instead and why?

IPA Response

The IPA broadly supports the rebuttable assumption in relation to recycling. However, as stated above, the IPA believes OCI should only include those items of profit and loss that would not be recognised as profit and loss in accordance with the entity's business model and only those items would be subject to recycling.

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?

IPA Response

Other than the inconsistencies noted at the response to Question 3, the IPA broadly agrees with the BCE.1-BCE.31.

Question 16 – Business activities

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

IPA Response

The IPA believes the CP only deals superficially with business activity in general and the business model in particular. Furthermore, the CP is silent on the risks associated with the entity's business activities and the management's activities to manage those risks.

Question 17 – Long-term investment

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

IPA Response

The IPA supports the IASB's conclusions on long-term investments subject to the consistency with the reporting entity's business model.

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).

As previously noted, the IASB is not requesting comments on all parts of Chapters 1 and 2, on how to distinguish liabilities from equity claims (see Chapter 4) or on Chapter 8.

IPA Response

The IPA is of the opinion that the current paragraph on going concern (3.10) needs to be more expansive. At a minimum, it should be consistent with the auditing standards. The CP guidance should make it clear the primary responsibility for determining the appropriateness of the going concern function lies with management and Those Charged with Governance.

Management Discussion and Analysis (MDA) is a critical aspect of financial reporting. Quantitative analysis without context and explanation only provides a partial picture of the financial position and results of an entity. The MDA provides a link between the financial numbers and the business activities of the entity. The IPA believes the CP needs to include specific guidance on the nature of appropriate MDA.

The IPA is disappointed the IASB has not taken the opportunity to update and expand Chapter 8 – Concepts of capital and capital maintenance. The IPA believes Chapter 8 should be expanded to deal with capital management concepts including the determination of appropriate capital levels, economic return on capital and dilutionary impacts of capital activities.