



A Review of the Conceptual Framework for Financial Reporting

The ABI's response to the IASB's DP/2013/1

1. The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK and for investments amounting to 26% of the UK's net worth. It represents its members both as preparers and users of financial statements.
2. We are grateful for the opportunity to comment on the IASB's discussion paper, *A Review of the Conceptual Framework for Financial Reporting*.

ABI comments

3. The discussion paper is a valuable step in the Board's project to revise the conceptual framework.
4. We welcome a number of specific improvements to the existing framework, such as including the greater emphasis on reporting the substance of transactions, and the retention of many current key concepts, such as equity as the residual of assets less liabilities.
5. We suggest some specific areas that would benefit from further analysis, especially on:
 - measurement, to give clearer support to the selection of different measurement bases. In this area in particular, the discussion paper seems to rely too much on existing standards' requirements;
 - presentation, to ensure that there are clear bases for:
 - the P&L as the principal performance performing statement, underpinned by the business model; and
 - the OCI as narrowly including only some items that could interfere with the view of underlying performance given by the P&L. Developments in the IASB's financial instruments and insurance contracts have highlighted this need, particularly an in appropriate requirement to use the OCI arising from an ill-developed view of an insurer's business model;

- the roles of stewardship, reliability, prudence, the business model, unit of account, and capital maintenance. The first three relate especially to investor concerns that shareholders should be recognised as the primary users of accounts. We expand on them in paragraphs 6 to 15 below because the IASB has considered chapters 1 and 3 to be complete but we think can be improved through some small but significant changes;
 - disclosure, to drive more focused reporting.
6. From the point of view of investors in particular, general purpose financial reporting needs to recognise that shareholders' requirements are qualitatively different from those of other capital providers. Shareholders constitute the ownership interest of the company, they provide it with risk capital from which they share proportionately in the returns and they have voting rights in relation to the appointment of management and the major decisions of the management. Their perspective should be central to the objective and presentation of financial reporting. The roles of other capital providers and creditors are different, being limited generally to a contractual relationship with the company to receive specified payments.
 7. Correspondingly, the responsibilities of the management to shareholders are qualitatively different. It is to shareholders that management are primarily accountable for their decisions about the company's resources and performance generally, rather than specific contractual performance. It is therefore the shareholders who have the greatest interest in the view given by the financial statements as a whole and the widest need to rely on them.
 8. Such general purpose financial reporting facilitates shareholder dialogue about all aspects of a company's affairs to ensure accountability (or "stewardship"), including, for example:
 - its competitive position;
 - the success of its strategy and the opportunities for adopting alternative strategies, and mergers and acquisitions and divestments;
 - capital management and financing – including dividends and other distributions and the equity issuance and buy-back;
 - risk profile; and
 - governance of the business.
 9. It also underpins the specific rights of shareholders to:
 - approve the annual report and accounts;
 - elect or re-elect directors whose responsibility it is to provide the true and fair view in the accounts; and

- appoint the auditor to ensure that that view is given.
10. The main consequences of this centrality of the shareholder perspective for chapter 1 of the conceptual framework is that the objective of general purpose financial reporting needs to be restated so as to recognise:
 - the primacy of the shareholder over other capital providers and creditors;
 - the responsibilities of management in being accountable generally to the shareholders, as well as in satisfying information needs relating to buying, selling or holding decisions; and
 - the need for an overall true and fair view of financial position and performance.
 11. It also has implications for chapter 3 of the conceptual framework, in relation to reliability and prudence.
 12. For information to be useful to shareholders, it must have the characteristics that the conceptual framework recognises, but it must also be reliable. In our view, reliability is qualitatively different from other aspects of what the IASB assumes is covered under the phrase, faithful representation. In particular, the concept of faithful representation underplays the role of uncertainty in IFRS. The removal of reliability from the conceptual framework fails to recognise that the need for the development of a specific IFRS is, in many cases, a response to an area of accounting and reporting with inherent uncertainties and aims to achieve greater reliability.
 13. The discussion paper states that the main reason for the change from reliability to faithful representation was 'a lack of understanding of the term reliability'. However, we suspect that misunderstandings arose as some focussed on reliability to the exclusion of all other considerations. Although, there are some cases where information should be reported even where it has only a low level of reliability, we do not consider that reliability concerns can always be met through adequate disclosure. Consequently, reliability should be considered as a separate fundamental qualitative characteristic.
 14. To ensure that accounting standards and, in turn, financial statements are reliable for shareholders, we believe it is appropriate to be prudent and err on the side of caution in the face of uncertainty, such that:
 - there is later rather than earlier recognition of revenues and assets;
 - there is earlier rather than later recognition of costs (incl. impairments) and liabilities; and
 - assets and income are not overstated and liabilities and costs are not understated.
 15. This need had been satisfied by the inclusion in the IASB's previous conceptual framework of prudence. That was a fundamental qualitative notion for guiding accounting standard setters and, ultimately, issuers (and auditors) when

exercising (or assessing) aspects of accounting that require judgement, or where adherence to the standards might otherwise result in outcomes that are misleading. This has particular relevance where there is no accounting standard to guide the recognition and measurement of items. Whilst we support the resumption of the term 'prudence', we recognise that that the term has a different role in other regulatory contexts, particularly in the prudential supervision of financial services companies. We strongly believe that the underlying concept should be restored as a separate characteristic in the framework but also be defined clearly to minimise the risk of confusion with its role outside of general purpose financial reporting..

16. Finally, it would be helpful for the IASB to clarify further how it approaches the use of a true and fair override. The true and fair override is considered an important shareholder protection and any uncertainty relating to its application should be resolved.
17. Our detailed responses to the discussion paper's questions are given in the appendix to this letter. Please note that we think that further impact analysis is needed for a number of aspects of the conceptual framework, and our comments should be understood in that context.
18. Whilst this letter highlights the main concerns of UK insurers, both as preparers and users of accounts, we also support the joint CFO Forum/Insurance Europe response.

Association of British Insurers
January 2014

A Review of the Conceptual Framework for Financial Reporting, DP/2013/1

ABI responses to discussion paper questions

Section 1 Introduction

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?

1. We agree with these preliminary views and that the IASB should not specifically undertake a comparison of all existing standards with the new framework. We consider that normal due process for specific projects that are added to the IASB’s work programme should be relied upon to take any inconsistencies into account in due course.
2. We also agree that parties other than the IASB may find the Conceptual Framework useful for the purpose stated in DP1.28. Accordingly, we do not support restricting the use of the Framework by preparers in formulating accounting policies for accounting items not addressed by a specific standard. The Framework should be an important reference point for accounting practitioners in providing guidance where uncertainties exist and key judgements need to be made, both in interpreting accounting standards and where accounting standards do not apply. For instance, it may be appropriate for a preparer to consider the Framework when determining whether an asset or liability should be recognised.
3. As we state in the summary, it may be appropriate for this section of the Conceptual Framework to clarify how the IASB approaches the use of a true and fair override.
4. The true and fair override in the preparation of financial statements should not be considered a circumvention of IFRS, but a legitimate, statutory requirement in

ensuring a true and fair view is reached. It also helps empower auditors' professional scepticism, beyond technical compliance with IFRS. We equally accept, however, that it should not be used to allow unlimited discretion over the application of financial reporting standards.

Section 2 Elements of financial statements

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?

5. We agree with these definitions.
6. We do not think that the proposed changes to the existing definitions would have much effect on current practice and we welcome the greater clarity, particularly from introducing 'capability' into the definition of economic resource. However, we suggest that the IASB should carry out further analysis of the impact of the new definitions, given their significance, to ensure the full implications of the revised definitions are understood
7. We agree that the IFRSs can cover existence uncertainty. However, the Conceptual Framework must also reflect the need for guidance on a matter that is not covered by a standard, so as to avoid inappropriate recognition. Here again, also, we suggest that more impact analysis is needed before an exposure draft is issued.

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?

8. We agree with the elimination of 'expected' from the definitions. We also agree that there should not be a probability threshold in the conceptual framework, either for existence or for recognition.
9. We think that many uncertainties about what accounts should show for assets and liabilities essentially relate to measurement, and some of those are also questions of the appropriate unit of account (see also under question 24 below). We also think that the remaining existence and recognition uncertainties are best dealt with in individual standards.
10. This is not to say that an accounting standards cannot be developed to include a probability threshold if that would be consistent with the need standards to be prudent and reliable. For instance, we would expect those standards to reflect the greater need to avoid recognising assets or revenues than liabilities or costs in conditions of uncertainty.

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?

11. We consider that the analysis in the discussion paper of the role in the framework of the elements in financial statements needs to be further developed before we can come to a view more generally, and we would not yet preclude defining the separate elements. We are not sure that it is appropriate to leave such conceptual distinctions entirely to a future project to revise presentation requirements at the standards level.
12. Capital maintenance is too lightly touched upon as a discussion area, both here and in chapter 9 – as we note under question 26 below.

Section 3 Additional guidance to support the asset and liability definitions

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?

13. We agree with the IASB's preliminary view, including that the definition of liabilities should be wider than simply obligations that are enforceable. Whilst we agree that some constructive obligations should be recognised as liabilities, they should be clearly distinguished from economic compulsion, and we agree that further guidance would be helpful.

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.

14. We agree that view 1 is too narrow. However, we are not sure whether we prefer view 2 or view 3, because we are not clear enough from the examples in what circumstances there would be a present obligation under view 3 but not under view 2. That suggests that view 3 does not rest on as firm a conceptual footing.
15. It is not obvious that liabilities should include everything that has arisen through past events and yet might be avoided through future actions. Indeed, it is not necessary to identify a past event in order to establish whether there is a present obligation, and therefore the definition of a liability need not refer to a past event – although we agree that consideration of a past event can help guide the accounting. Further analysis would be helpful. Otherwise view 2 should guide the further development of the framework.

Question 7

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

16. We agree that the conceptual framework should support better the preparation of financial statements on the basis of substance rather than only legal form, not least because this is a significant consideration in accounting for insurance contracts. We also support including principles to underlie the guidance in individual standards, and we agree broadly with the principles proposed in paragraph 3.102. Furthermore, we agree that improvements could be made to the treatment of executory contracts (whilst ensuring that economic compulsion does not, of itself, create a liability).
17. We also agree that extra guidance should be given on the concept of control underlying the definition of an asset. However, we are concerned that the extra guidance in paragraphs 3.27-3.34 may not be sufficient to reduce the current variability in interpretation of what constitutes control. In our view, consideration of who bears the risk and reward are central to the analysis of control in practice, and the extra guidance should be developed more on this basis.

Section 4 Recognition and de-recognition

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?

18. We agree with the overall approach and, specifically, with 4.25 (a) for a relevance test. However, consistent with our response to Section 9, we believe that 4.25 (b) should be amended to replace “faithful representation” with “reliability”.
19. The conceptual framework should also seek to develop guidance, similar to that provided in paragraph 4.26, to provide indicators of when recognition might not result in relevant and reliable information. These include the key ideas of measurement uncertainty and low probability of inflow or outflow of economic benefits, which are contained in the existing Conceptual Framework.
20. The proposal only makes reference to assets and liabilities and does not distinguish between recognition of revenues and costs. As described in Section 9, we believe that more timely recognition of costs is more important than that of revenues. The Conceptual Framework should highlight that reliability may require earlier recognition of losses than of gains. This may be something that can be addressed in the guidance document we propose.

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?

21. We welcome the detailed analysis of the issues arising from derecognition as the basis on which further consideration can be given to the need to reflect the substance of transactions. As in our answer to question 7 above, we are not convinced that the concept of control can be separated entirely from consideration of who bears the risk and reward, and so we are not clear that the analysis in paragraphs 4.36 to 4.49 covers all the considerations that might come into play with different examples from the two given (4.1 & 4.2).
22. Whether an asset or liability is recognised or derecognised should depend on the economic substance of the transaction. Furthermore, where the economic substance is doubtful prudence requires that caution is exercised in recognition, for example of income on transactions.
23. As to the possible approaches to take in an individual standard, we are not sure that the choice of which to take would be sufficiently supported by the analysis given, and we suggest that further work is needed particularly as between approaches (b) and (c). We are sceptical that enhanced disclosure (approach (a)) can be sufficient.

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

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?

24. We agree with the broad principles underlying the IASB's views (a) and (b).

25. In relation to view (c), we are not yet convinced that this is approach that the IASB should take. It would more clearly make more sense were the balance sheet of a company to reflect its current value. But a balance sheet also has cost-based items and is not complete – eg it lacks some intangibles. We are also confused by the notion of equity as a 'claim' rather than a residual interest.

26. We do not agree with view (d). We see no general merit in forcing the most subordinated class of instrument into the equity category (although this may be appropriate exceptionally, as in IAS 32), just because the entity happens to have issued no instruments that satisfy the definition of equity. Crucially, such an approach may be inconsistent with the notion of ownership which we consider to underlie the concept of equity.

Section 6 Measurement

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?

27. We agree with the overall approach. However, consistent with our response to Section 9, we believe that the objective of measurement should be amended to replace “faithful representation” with “reliable representation”. Further, Q11 (b) could be expanded to incorporate the role of prudence in providing reliable information:

“a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements, particularly in cases where assets and income are at risk of being overstated and liabilities and costs understated.”

28. We particularly welcome the inclusion of other cash-flow-based measurements for use (paragraph 6.52) where cost or market price is not relevant, or is too difficult or costly to obtain. We think, however, that the analysis of measurement issues could be developed more. It seems to comprise a restatement of the objectives of financial reporting generally which are taken as justifying a number of existing standards’ requirements.

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.

29. We do not disagree with the analysis but we are concerned that it does not go far enough overall to support a treatment that might be proposed in a particular standard. To illustrate this, we wonder how the analysis can be reconciled with accounting for stock at cost under IAS 2 (notwithstanding the pre-emptive standards-level dismissal of this concern in paragraph 6.80) and with the revaluation of property, plant and equipment under IAS 16. As under question 12 above, we suggest that further conceptual work is needed in this area.
30. We also consider that the analysis in this section is incomplete in that it does not address fully enough situations where multiple factors apply, e.g. where an entity holds an asset both for sale and to collect the future cash flows. Further, the measurement basis for assets and liabilities should also reflect any linkage between assets and liabilities - which is particularly relevant for insurance companies.

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.

31. We agree, other than that we are concerned that the analysis in paragraphs 6.112(c) and 6.115 is incomplete in not covering also the compensation an entity requires for uncertainty in liability measurement.
32. We agree that current exit prices are likely to be the relevant measure for liabilities that will be transferred – but, as there will often be no market, it is unclear that ‘current market prices’ is an appropriate description.

Question 14

Paragraph 6.19 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 (ie the asset or the liability is highly leveraged).*

Do you agree with this preliminary view? Why or why not?

33. We agree.

Question 15

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

34. We disagree with the assertion in paragraph 6.24 that subsequent measurement should always be the same as, or at least consistent with, the initial measurement. IAS39, for example requires initial, but not subsequent, measurement at fair value. Furthermore, an item might properly be reclassified during its life, and its measurement basis change accordingly.

Section 7 Presentation and Disclosure

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.

35. We agree with the IASB's views about (a)(i), (ii) and (iv),

36. With regards to (a)(iii), as we explain under question 23 below, we suggest that the notion of the business model is most useful generally for presentation of items within the P&L and OCI, including questions of classification and

aggregation, in order to give the flexibility needed to facilitate relevant performance presentation. We think that market pressure within sectors with similar business models would result in sufficient comparability within sectors. This would mean in consequence that the presentation requirements at the standards' level could be minimal. We acknowledge that this could hinder cross-sectoral comparison, but we consider the need to be less significant.

37. In relation to (a)(v), we do not accept that all primary financial statements are equal. We regard the P&L account as the principal performance reporting statement, with primacy over the OCI. We consider that items should be accounted for in the OCI only to the extent that their inclusion in the P&L account hinders or prevents an appropriate view in the P&L of the entity's financial performance.
38. We support the IASB's disclosure objective. We suggest that the guidance on disclosures would benefit from having a more conceptual basis, such as that set out under question 18 below.
39. Consistent with our response to Section 9, that the Conceptual Framework should identify the provision of information that provides accountability or "stewardship" as a primary objective. We propose that the objective of primary financial statements provides equal prominence to accountability. Therefore, we suggest that paragraph 7.17 is amended specifically to refer to accountability, rather than as a subcomponent in 17.18.

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?

40. We agree with this approach overall, although we think it might help further if there were to be an explicit statement in the conceptual framework that immaterial items should not be included in financial statements.

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?

41. We agree that communication principles should be part of the conceptual framework, and we largely agree with those set out in paragraph 7.50. However, we also suggest that further analysis may help to identify more fundamental concepts, such as:

- values given to items in the primary statements, for example requiring greater disclosure where there is uncertainty in measurement;
- significance of the items to the entity's financial position and performance, for example IFRS 7's risk disclosures and fair value disclosures where items are carried on other value bases; and
- role of the items in the entity's operational performance, for example linkages between assets and liabilities.

Section 8 Presentation in the statement of comprehensive income – profit or loss and other comprehensive income

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?

42. We agree. We consider this to be a key reporting line.

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?

43. We agree. As we think that the P&L account is the principal performance reporting statement, we also think there should be a presumption in the

conceptual framework that recycling should be applied – albeit there might be some exceptions in individual standards, such as for pension liabilities.

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.

44. As under question 16 above, we regard the P&L account as the principal performance reporting statement, with primacy over the OCI. Items should be accounted for in the OCI only to the extent that their inclusion in the P&L account hinders or prevents an appropriate view in the P&L of the entity's financial performance. This is a high bar to be passed before the OCI may be used, and we agree with the IASB that it is not passed by any of the factors considered in isolation in table 8.1 – unrealised, non-recurring, non-operating, measurement uncertainty, long-term and outside management control.
45. We therefore favour a narrow approach. However, we have significant concerns about what the IASB considers that narrow approach to be. We disagree with the objective of recognising an item in OCI if that enhances the relevance of profit and loss. We consider that it should instead reflect the negative test that we propose in paragraph 38 above, as that is more tightly drawn and would lead to fewer difficulties in application – that items should be accounted for in the OCI only to the extent that their inclusion in the P&L account hinders or prevents an appropriate view in the P&L of the entity's underlying performance
46. Secondly, (and consequentially), we disagree with the second attribute proposed in paragraph 8.46(b), that would have an item recognised in OCI if that enhances the predictive value of the items in profit and loss. We do not agree that it is the only primary purpose of items in the P&L account to be predictive of future cash flows. We consider that this is inconsistent with the statement at the start of the same paragraph (8.46), with which we agree, that items within profit and loss provide the primary source of information about the return an entity has made on its economic resources – which is in the period of account to the balance sheet date – and is not about the return it may make in future periods of account although the assessment of the sustainability of returns may be helped thereby.
47. We suggest that the IASB's evaluation of its proposed principles, particularly 'bridging', should be looked at afresh in the light of our proposed restatement of

the objective of recognising items in OCI. We highlight ‘bridging’ because we think that there might be other items with bridging characteristics which the IASB would not propose to be included in the OCI, and it is not clear how the IASB’s analysis makes this differentiation – other than by what appears to us to be a rather vague reference to cost and complexity.

48. Correspondingly, we also do not support the broad approach, as it is inconsistent with the P&L account being the principal performance statement.

49. We recognise that there may be exceptions to the Board’s general approach that would need to be determined at the standards level eg pensions.

Section 9 Other issues

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.

50. As stated in paragraphs 6 to 15, it is particularly important to investors that shareholders are recognised as the primary users of accounts. The main consequence of this for chapter 1 of the Conceptual Framework is that the objective of general purpose financial reporting needs to be restated to recognise:

- the primacy of the shareholder over other capital providers and creditors – as reflected in the structure of the balance sheet and performance statements;
- the responsibilities of management in being accountable generally to the shareholders, as well as in satisfying information needs relating to buying, selling or holding decisions; and
- the need for a true and fair view overall, of financial position and performance.

51. We, therefore, propose the following changes to OB2 and chapter 1 more broadly.

OB2:

“The objective of general purpose financial reporting is to present a true and fair view of the performance and financial position (state of affairs) of the entity for the benefit of its shareholders and other users of accounts¹. This will provide useful information in making decisions about providing resources to the entity and for assessing the quality of management and governance.”

52. This high-level objective is currently accompanied by supporting wording in the subsequent section² which expands on the decision-usefulness dimension. This should be supplemented with a section which expands on, and clarifies, users’ requirement for accounts to help assess the accountability of management and the governing body. This is multi-faceted and has separate distinct capacities which we outline in paragraphs 59-65.

Accountability

53. The directors, acting as the agents of the enterprise, and therefore of shareholders, protect the interests of the shareholders, as the owners of the company. Therefore, financial statements provide shareholders with an opportunity to assess the effectiveness of management, and provide management with a means of reporting the results achieved.

54. This requires information that goes beyond that required for decisions such as whether to buy, sell or hold the shares. An accountability perspective emphasises the need for transparency and reliability and a focus on long-term considerations. In this sense the board has a responsibility to present a fair, balanced and understandable assessment of the company’s position and prospects.

55. Therefore the interests of shareholders in the financial reporting process go beyond buy and sell decisions. These are separate distinct capacities, for example:

- **Ownership:** to inform their personal decision-making regarding their property by conveying the performance of the company and its business model. Owners need to be able to understand the economic position irrespective of an ability or desire to buy and/or sell through the market.

¹ For example, potential investors, lenders, and other creditors.

² “Information about a reporting entity’s economic resources, claims against the entity and changes in resources and claims”

- **Financial and transactional decision-making:** to inform the business of General Meetings to aid decision making in respect of the entity. These relate to shareholders' powers to approve resource allocation decisions, such as:
 - dividends and other distributions;
 - issuance of new equity;
 - mergers and acquisitions; and
 - divestments or the winding up of the company's business.

This information should be decision-useful, in the sense that shareholders need to develop an informed view on how their assets will be allocated and, in turn, how they will exercise ownership, as well as for buy and sell decisions in the market.

- **Management performance:** as a means of accountability, inform shareholders of the performance of management, the quality of long-term decision-making, particularly in relation to capital stewardship, and the robustness of the governance framework that underpins and challenges such decision-making on behalf of shareholders. This should inform decisions on whether to, for example:
 - approve the annual report and accounts;
 - elect or re-elect directors;
 - approve the directors' remuneration; and
 - appoint the auditor and its fees.
- **Overcoming asymmetric information between principal and agent:** through a requirement to provide a true and fair view, and therefore reliable and prudent information, ensure that management decision-making is aligned with shareholders. This should ensure that no misleading information is provided to shareholders, irrespective of the detailed requirements under a specific IFRS, and provide a level of transparency and accountability that promotes the right behaviours in seeking economic efficiency in a time predating the reporting.

56. The above aspects are increasingly integrated into the mainstream investment process and, therefore, the concepts of decision-usefulness and stewardship should not be seen as separate objectives; the dichotomy of "voice or exit" is misleading. Increasingly, asset managers formulate views on the quality of governance and management to inform both initial investment decisions and ongoing portfolio decisions. For example, subsequent interactions and changes in a company's approach may alter valuation considerations. For this reason,

accountability should not be subsumed under decision-usefulness in the conceptual framework, but incorporated as an equal weighted objective within OB2, as proposed above.

Reliability

57. As we note in paragraphs 11 to 16, for information to be useful to, and trusted by, shareholders, it must be reliable. Reliability is qualitatively different from faithful representation.
58. Currently a faithful representation is considered to have been given if adequate disclosure is made. This could include, for example, the nature of the asset or liability, the measurement basis used and the uncertainties that significantly affect the amount. Therefore arguably any measurement basis of any asset or liability could be consistent with the idea of 'faithful representation' where there is "suitable disclosure". If 'faithful representation' fails to exclude the provision of any information, it cannot sensibly guide the development of accounting standards.
59. It is also currently the case that the most relevant information should always be reported if it can be faithfully represented. If almost anything can be faithfully represented, it follows, therefore, that the Conceptual Framework, arguably, effectively requires that relevance prevails over reliability in all cases.
60. We therefore propose replacing faithful representation with reliability as a fundamental characteristic in chapter 3 and making the following change at the end of OB11:

"... Nevertheless, establishing a goal towards which to strive is essential if financial reporting is to evolve so as to improve *its reliability and, therefore, usefulness.*"

Prudence

61. Financial statements cannot provide an objective and impartial report of all aspects of an entity's financial position and performance. Such a report would have to be complete and comprehensive, which would ignore the role of uncertainty in financial standards and statements. No-one should believe that financial reporting captures the 'true' economic value of the entity or its 'true' economic profit.
62. Given this, prudence is a necessary characteristic for informing accounting standards so as to provide a safeguard for users so that reliable information is provided to shareholders. It is on this basis upon which views can properly be formed about the directors' stewardship of shareholder and creditor capital, the going concern status of the business and the capital properly available for distribution.

63. It is also of vital importance when there is no obvious accounting standard to guide issuers and where the Framework will be a reference point for developing accounting policies on items that require significant judgement.
64. The notion of prudence is consistent with many features of current accounting:
- Assets are written down when impaired to reflect bad news but not written up for good news.
 - Provision is made for onerous executory contracts, but gains on contracts that are expected to be profitable are not recognised.
 - Inventory is stated at cost, even when a future sale is highly probable and even if an order has been received.
65. It is important, however, that clarity exists as to where prudence applies and, therefore, its role in the Conceptual Framework. Therefore, the IASB should seek to provide guidance on its appropriate application to ensure there are no perverse outcomes, such as the potential for multiple applications of prudence at different stages (e.g. double counting) or inappropriate bias.
66. We believe that the role of prudence is in the development of accounting standards and policies i.e. used as an important concept that should guide accounting standard setters to ensure that, in conditions of uncertainty, recognition and measurement are undertaken in an appropriate manner.
67. The appropriate approach is likely to be dependent on the accounting standard under consideration, but the IASB should seek to clarify the appropriate approach with guidance. It may also be helpful for the IASB, as a general rule, to comment on prudence for each standard, explaining how the standard reflects the concept. Prudent accounting is not consistent with bias and systematic reserving, however, any such generally agreed parameters should seek to ensure that accounting standards do not result in bias.
68. Outside of this, as we state under question 1, the description of prudence, and indeed the whole conceptual framework, has an important role guiding issuers where no accounting standards apply.
69. We propose that prudence be reinserted as a characteristic of reliability and that the following wording be inserted as a passage within the section QC12-16:
- “To ensure that accounting standards provide reliable financial statements for shareholders, it is appropriate to be prudent in the face of uncertainty at an individual item level. This should generally result in a predisposition, such that accounting standards provide that:
- There is later rather than earlier recognition of revenues and assets;

- There is earlier rather than later recognition of costs (incl. impairments) and liabilities; and
- Assets and income are not overstated and liabilities and costs are not understated.”

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?

70. IASB should take into account why entities enter into transactions and hold assets and liabilities, in developing accounting standards. As shorthand for this general approach, the term, ‘business model’, serves well.

71. We are concerned, however, that notion of the business model has been used to support both the retention by individual entities of accounting approaches that conflict with other key aspects of the IASB’s proposals for IFRSs, and also by the IASB mandating requirements in developing IFRSs. Our concern is that the notion is too vague: in the first case, to prevent it being called upon in a way that undermines comparability; and in the second case, to prevent accounting requirements being forced onto entities that interfere with appropriate performance presentation.

72. The IASB’s project to develop a new IFRS for insurance contracts illustrates these difficulties. Some insurers, but not all, claim that a requirement to discount their claims liabilities is inconsistent with their business model, and it is not clear that the loose way in which ‘business model’ is referred to would prevent this. For the second, the IASB intends to require the use of other comprehensive income for the effect of changes in discount rates on insurance liabilities. It does this on the basis of a misunderstanding of what many insurers do. It assumes that all insurers only match insurance liability cash flows with debt security cash flows (hence its parallel proposals for mandating OCI in IFRS 9). But insurers largely do not do this. General insurers largely do not aim for cash-flow

matching. Life insurers do aim for it, but they cannot usually achieve it. There are insufficient debt securities on the market with appropriate duration. Many therefore use derivatives as well, and for foreign exchange risk. And many insurers also invest in assets other than debt securities, eg commercial mortgages and property, and equities.

73. We suggest that further analysis should be undertaken of the notion of a business model before any great weight is placed upon it as a concept in the conceptual framework, such supporting a requirement to use the P&L or OCI.
74. Nevertheless, we suggest that the business model is likely to be useful in guiding the development of presentation requirements for items within the P&L and within OCI. We think that market pressures would drive the greatest comparability and relevance within sectors when presentation is based on business models, and that therefore that presentation requirements at the standards level can be minimised.

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?

75. We recognise that the standards themselves play a key role in determining appropriate units of account. However, such is the significance of the different possible effects, for example where liabilities are at expected values or represent most likely outcomes, we would welcome further analysis of the issues with a presumption that the conceptual framework should give more guidance, and that the standards themselves should be clear on what unit of account is required. We note that the IASB itself has shared this view in the past, for example in acknowledging, in its exposure draft on derecognition, the lack of guidance in the current framework and stating its intention that the conceptual framework project should address this.

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?

76. We have not identified 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.

77. We are not convinced that the need for further analysis of capital maintenance concepts arises only for high inflation accounting. We suggest that it may have implications for a number of conceptual issues relating to measurement (such as what gets revalued and what does not) and the purposes of the primary statements ((such as what is reported in P&L or in OCI). The discussion paper itself recognises this in paragraph 2.51 but, disappointingly, takes it no further.