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Dear Ms Flores,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on two EFRAG Bulletins, *The asset/liability approach*, and *Accountability and the objective of financial reporting*.

Principal authors of this comment letter were Gerhard Prachner, Alfred Wagenhofer and Christian Gross. In order to provide a balanced Austrian view on the Bulletins, the professional background of these authors is diverse (one auditor and two academics).

GENERAL REMARKS AND SUMMARY

We believe both Bulletins raise fundamentally important issues in the Framework debate. We believe the Bulletins give a good summary of the main arguments. At the same time, both have been discussed for a long time and many arguments have already been put forward in those debates. And it is obvious from the tentative views in the Bulletins that there is little agreement among the five institutions that are responsible for the contents of the Bulletins. This is not surprising, as there are many effects that require evaluation and decisions by the standard setters.

We summarise our views on the two issues below:

- Asset/liability approach: We believe the asset/liability approach should be retained conceptually, but care is necessary in defining assets and liabilities, and recognition criteria. Potential deficiencies in the asset/liability approach should be addressed by adapting it to account for undesirable outcomes in particular instances.
- Accountability: We strongly support the inclusion of accountability in the Framework as an objective of financial reporting on the same level as decision usefulness. Alternatively, one might reconsider broadening the definition of decision usefulness to comprise valuation and accountability, even though we consider this approach to be only a second-best solution compared with the inclusion of accountability as a separate objective of financial reporting.

Specific remarks

1. Bulletin "The asset/liability approach"

(i) Are there any arguments for and against the asset/liability approach - defining income and expenses in terms of changes in assets and liabilities - that are not discussed in the Bulletin?

We note at the outset that the debate about the preferability of the asset/liability approach or the revenue/expense approach stretches back through over a hundred years of accounting theory. The main arguments have not changed; the only difference from earlier times is that new and more complex transactions have proliferated and given rise to a plethora of additional considerations – the last two examples in the Appendix illustrate such instances. This long-term debate suggests that there is no clear dominance of one approach over the other, and that the standard setter must trade off their positive and negative effects.

Given that, we believe the main arguments are included in the Bulletin.

However, we would point out that EFRAG's approach – discussing the asset/liability approach in a different Bulletin from performance reporting – is likely to result in repeated arguments and to ignore or underweight the strong relationship between these two topics.

(ii) Do you believe that the asset/liability approach should be retained or revised? If changed, what alternative would you propose?

There are two basic questions: (1) Which approach seems to provide more useful information overall? (2) Selecting this approach, can adjustments or departures from that approach in particular circumstances help improve potential deficiencies?

In answer to (1): Generally, we believe the asset/liability approach should be retained. We think this approach provides a conceptually more disciplined framework for accruals and for

the earnings management associated with such accruals than the revenue/expense approach, especially as the revenue/expense approach can lead to accruals in the statement of financial position that do not fulfil the recognition criteria for assets and liabilities and, perhaps more seriously, the non-recognition of liabilities (the example of pension obligations is mentioned in the Bulletin).

We note, however, that the preferability of the asset/liability approach critically depends on the definition of assets and liabilities and the recognition principles. If assets are defined very broadly, so that, e.g., internally generated intangible assets become the subject of recognition, we believe that this could be at least as problematic as the existence of deferrals under the revenue/expense approach that are neither assets nor liabilities.

In answer to (2): While we generally prefer the asset/liability approach, we believe it needs to be adapted for recognition and measurement outcomes that are at odds with what one would consider to be part of the performance of an entity. E.g., gains and losses from foreign currency translations are seldom relevant to assessment of the performance of an entity. Of course, systematically identifying what might be “at odds” with the measurement of an entity’s performance requires additional criteria and perhaps specific exemptions.

Even if we prefer the asset/liability approach, we see some merits in arguments for the revenue-expense approach, such as profit or loss (and other income figures) being the most important aggregate measures of performance conveyed by financial statements, which should not simply be “residuals” of the change in net assets. However, either of the two approaches can be adapted so that it provides a useful measure both of performance and of the financial position of an entity. And we are certain that one can find examples that illustrate deficiencies of both approaches.

We also understand the fear expressed in paragraph 23 of the Bulletin, that some might see fair value measurement as an inevitable consequence of the asset/liability approach. The combination of fair value measurement and the asset/liability approach is the essence of what has been developed as “economic income” in the valuation literature, and the “inevitability” might result from the fact that this concept is conceptually consistent. Particularly in practice, however, it has obvious problems, e.g., the underlying assumption that the value of all assets and liabilities is identifiable and verifiable at any point in time.

The strategy the IASB pursues in its Framework Discussion Paper is a way to cope with potential deficiencies of the asset/liability approach. For example, the DP does not suggest that fair value is the conceptually most appealing and therefore preferable measurement concept, but rather follows a business model approach. The DP also discusses a format of the statement of comprehensive income and particularly OCI, which includes “bridging items” and “mismatched remeasurements.” The first group of items acknowledges that information from two different measurement bases can be equally important, and the second group reminds us of the matching principle that appears to underlie these items.

(iii) Do you have any other comments on this Bulletin?

We note that the examples in the Appendix illustrate potential deficiencies of the asset/liability approach, while other examples, e.g., some that clearly show the asset/liability approach to be preferable to the revenue/expense approach, are missing. We understand that this Appendix is included to show that the arguably overwhelming preference for the asset/liability approach has some deficiencies. Nevertheless, we would prefer a neutral set of illustrations in which the asset/liability and the revenue/expense approach provide substantially different outcomes.

2. BULLETIN "ACCOUNTABILITY AND THE OBJECTIVE OF FINANCIAL REPORTING"

(i) Are there any arguments for and against the objective of accountability that are not discussed in this Bulletin?

The Bulletin raises many important issues with respect to accountability. We believe it could be useful to emphasise that the original objective of accounting was accountability; decision usefulness to capital providers became important only in recent decades with the development of capital markets. However, decision usefulness is only an additional objective, but does not replace the need for accountability, which is still important.

While IFRS are mainly relevant for large and listed entities, for which one may argue that decision usefulness is more important, IFRS are also used by non-listed entities, for which the relative importance of the two objectives reverses. Further, and even more significantly, the Conceptual Framework has (so far) been extended to IFRS for SMEs. We think that this issue is a relevant one and currently not enough explored. SMEs are not using public equity markets, so the decision-usefulness objective is much less important than the original objective of accountability. Hence, we believe that this aspect of the Framework should be considered as well.

We also believe that determining the objective(s) of financial reporting should take into account that information sources other than financial statements exist, especially for listed entities. Management expectations in particular are communicated more effectively in other reports. The comparative advantage of financial statement information over other sources of information is that they provide reliable, verifiable, and auditable information. This information is generally less timely than that from other sources, but has these other qualities that are important for decision usefulness and accountability.

As the Bulletin notes (paragraph 24), there is significant overlap between accountability and decision-usefulness, but there are several instances where they can lead to different outcomes. If accountability is not included as a separate and equally important objective of financial reporting, the standard setter will have to decide on such instances on the basis of

the decision-usefulness objective alone. Including both objectives with similar weight would require the standard setter to explicitly trade off the outcomes resulting from either objective. For example, the standard setter could evaluate which objective should have the greater weight in determining the accounting amounts recognised and which is better dealt with through additional disclosures. We note that the discussion of measurement bases in the IASB DP suggests that two different measurements can be useful, using OCI to account for the "bridging items".

(ii) Do you believe that the objective of accountability is appropriately reflected in the existing Conceptual Framework? If not, how should the Framework be amended?

On the basis of the comments above, we strongly support the inclusion of accountability in the Framework as an objective of financial reporting, in addition to decision usefulness. We do not support the view that the current Framework – with its inclusion of accountability as part of or ancillary to decision usefulness – is sufficient to require the standard setter to trade off these two objectives.

Alternatively, it has been discussed whether decision usefulness should be more broadly defined, e.g., as in the IASB's ED on the Conceptual Framework Phase A (2008). It focused on "present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers", which comprises accountability ("usefulness of financial reporting in assessing stewardship") as well as valuation ("usefulness of financial reporting in assessing cash flow prospects"). This definition was supported in many comment letters and it remains unclear to us why the IASB and the FASB nevertheless went for a narrower definition of decision usefulness in the 2010 Framework. We still feel that this approach does not reflect accountability appropriately, and that the inclusion of accountability as a separate objective of financial reporting is a more comprehensive solution, which more adequately reflects the importance of accountability for accounting practice.

Additionally, we suggest considering whether the same Framework objectives are useful for listed entities and SMEs, or whether the weight attached to the two objectives differs for these two categories of entities.

(iii) Do you have any other comments on this Bulletin?

We have some minor comments on the examples in the Appendix: with regard to paragraph A2, we do not fully understand the rationale behind the conclusion that incompleteness of financial statements may enhance decision usefulness. Of course, persistence and recurrence of items are important, (e.g., for forecasting), but, as the discussion of management responsibility for non-recurring items suggests, recurrence is an important issue for accountability as well.

As mentioned above, accountability seems to require more reliable information than decision usefulness. This difference between these two concepts may affect the accounting for, e.g., internally generated intangibles, which is to a large degree based on management estimates. Using management estimates for performance evaluation of management (a major aspect of accountability) is certainly less useful than for decision usefulness.

Kind regards,

Romuald Bertl

Chairman