

**Russell C Picot**  
*Group Chief Accounting Officer*

European Financial Reporting Advisory Group  
35 Square de Meeûs  
B-1000 Brussels  
Belgium

5 July 2013

Dear Sirs

## **European Financial Reporting Advisory Group's 'Getting a better framework' bulletins**

We welcome the opportunity to provide comments on the European Financial Reporting Advisory Group ('EFRAG') bulletins on key aspects of the conceptual framework.

HSBC is one of the largest banking and financial services organisations in the world, with assets of US\$2,681 billion at 31 March 2013. Headquartered in London, HSBC serves customers worldwide in 81 countries and territories in six geographical regions. HSBC provides a broad range of financial services and products organised through four global businesses, Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets, and Global Private Banking.

We support EFRAG's intentions to discuss the conceptual framework and with the aim of forming a European view, before the International Accounting Standards Board publishes its proposals. We believe that there is a role for prudence in financial reporting, and that has been reflected appropriately in the conceptual framework and at the standards level. While some may think there is a conflict with neutrality, we believe that an appropriate balance has been found, particularly in how requirements are expressed at the standards level. In terms of reliability of financial information, we believe that faithful representation is an appropriate characteristic that may be more capable of consistent translation, provided it is properly defined, with reference to the features of reliability and verifiability. Finally, we support the view that there should be a probability threshold for the recognition of assets and liabilities, and believe that including probability only at the stage of measurement would reduce the relevance of financial statements.

Our responses to the questions set out in the bulletins are provided in the Appendix. As always, we would be pleased to discuss our comments and concerns in more detail if this would be helpful.

Yours sincerely



**HSBC Holdings plc**  
Level 39, 8 Canada Square, London E14 5HQ  
Tel: 020-7991 8888 Fax: 020-7991 4624

Registered in England number 617987. Registered Office: 8 Canada Square, London E14 5HQ.  
Incorporated in England with limited liability.

## Appendix: Questions for respondents

### *Prudence bulletin*

**(i) Is there a role for prudence in the development of accounting standards? if so, should it (i) focus on recognition and measurement criteria, and the timing of recognition of gains and losses; or (ii) be described as the general exercise of caution?**

Yes. We believe in a balanced approach, where prudence should be implicitly applied in standards on recognition and measurement rather than described as a general exercise of caution. Prudence should never be interpreted as an invitation to deliberately misstate assets and liabilities or to include excessive conservatism which may serve other purposes, such as prudential regulation, rather than providing the most useful information to investors. Consequently, we do not consider the principle of prudence as being incompatible with neutrality. IFRS as a whole strikes an appropriate balance between the conceptual framework concept of neutrality and standards level requirements which focus on not overstating assets or understating liabilities.

**(ii) Does the current Framework adequately reflect the essence of prudence, or do you share the tentative view that its role should be explicitly considered? If so, how would you characterise the level of caution you believe should be observed? references to various views in the bulletin would be helpful.**

As discussed above, we do not share EFRAG's tentative view that the role of prudence should be explicitly considered in the conceptual framework.

**(iii) Are there requirements in current IFRS not mentioned in this Bulletin which fail to reflect prudence? Are there requirements in current IFRS which in your view are overly prudent?**

We are not currently aware of any requirements in IFRS which involve an inappropriate level of prudence.

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

We have no further comments.

### *Reliability of financial information bulletin*

**(i) Are there any arguments for either of the views set out in the Bulletin that we have not discussed?**

We are not aware of any additional relevant arguments.



**(ii) Which view do you support? Why?**

Replacing ‘reliability’ (free from material error and bias, and can be depended upon to present a faithful representation) with ‘faithful representation’ (complete, neutral and free from error) appears to be little more than a matter of semantics. Provided enough background is given around the term ‘faithful representation’, as a term which is designed to include the notion of reliability, the framework appears adequate. A reference could be made to the four enhancing qualitative characteristics of comparability, verifiability, timeliness and understandability - in particular verifiability is an important feature of reliability.

Relevance is considered first, then if information is considered relevant, it is evaluated for its ability to provide a faithful representation of phenomena, and only if both criteria are met would an item be recognised in the financial statements. This removes the conflict between the two concepts, as both criteria must be satisfied, although it could be argued that until sufficient faithful representation occurs, relevance is traded off against faithful representation.

***Uncertainty bulletin***

**(i) Are there any arguments for either of the views set out in the Bulletin that we have not discussed?**

We are not aware of any additional relevant arguments.

**(ii) Which view do you support? Why?**

We support ‘view 2’ and believe that uncertainty is relevant to both the measurement and the recognition of assets and liabilities.

‘View 1’ in the bulletin implies that removing uncertainty from recognition results in the recognition of any possibility of future cash flows in the financial statements, with uncertainty being reflected only in the measurement of the asset or liability. We would not support such an approach which would result in the recognition of assets/liabilities where the possibility of cash inflows or outflows is considered remote. This risk is that these items would obscure more useful information in the financial statements. We agree that a probability-based recognition threshold leads to a binary choice, between recognising and not recognising an asset or liability. However, if it is inappropriate to recognise a potentially significant item, then sufficient disclosure can be provided so that users of the accounts can understand the item in context.

For ‘view 1’, we agree that creating a robust recognition threshold would require further guidance around the meaning of ‘probable’. Any such definition would be open to interpretation. However we do not think that the solution is to remove probability considerations from recognition. If all items, however improbable, are recognised, then the uncertainty must be dealt with as part of a probability-weighted average approach to recognition. If the probability were close to zero, then there would be no material difference to the financial statements between performing a difficult and judgemental calculation to reach this conclusion, and assessing probability as part of the recognition criteria.

We agree with ‘view 2’ which states that making recognition threshold judgements is simpler than making judgements necessary to measure an asset or liability based on all possible

expected outcomes. We also agree that recognising elements with a remote likelihood of occurring, with all of the ongoing monitoring that would be required, would be unlikely to yield benefits greater than the cost of the exercise.

**(iii) What are your views on the different ways in which a probability-threshold could be applied?**

We believe that a consistent definition and application of the concept of ‘probable’, across all standards, would be a useful improvement to IFRS.