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Françoise Flores, Chair
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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 EFRAG's Bulletins *Getting a Better Framework (Prudence, Reliability of Financial Information, and Uncertainty)*.

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

The three topics dealt with in the Bulletins are important conceptual underpinnings for several of the main principles that should be established in the Framework.

It appears that the controversial debate about fair value versus cost measurement is the underlying issue in each of the three Bulletins. We are not sure whether keeping this issue an implicit one is beneficial, or whether focussing directly on this aspect would not be a sensible way to discuss the topics addressed in the Bulletins. In particular, there are several alternative measurement approaches (such as value in use or deprival value) that many would favour.

SPECIFIC REMARKS

1. BULLETIN "PRUDENCE"

(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?

We believe that the distinction currently drawn in the Framework between conservatism (as the deliberate understatement of net income) and prudence (as caution in making judgments) is useful and should be continued. We also feel that the different terms, such as prudence, caution and conservatism, should be clearly defined and distinguished from each other to avoid potential misunderstandings.

We consider prudence in the sense of caution important as a general characteristic of financial statements because the primary function of financial statements is to provide highly reliable information. There are other sources of information that may be considered more important than financial statement information, but financial statements provide assurance as to the extent that other information can be trusted. Prudence is a means to counteract potential misrepresentation of managers' information and to neutralise any adverse effects.

We think prudence – in the sense of exercising caution – should be a general Framework principle which can then be used as a basis for individual rules in standards. If there was no such principle, it would be difficult to derive rules that are prudent in specific standards, as recognition and measurement criteria are a consequence of general principles. We particularly note that current IFRSs include a variety of rules that lead to prudent accounting, even though prudence is explicitly not part of the new Framework any more. This inconsistency could easily be avoided by including the notion of exercising caution in the Framework.

We would also point to another way of understanding prudence, namely as carefulness. This sense, which is useful when it comes to the application of statistical techniques and the related estimation of uncertain parameters, can be important for recognition and measurement, e.g., in actuarial computations. If parameters in computations of this kind are uncertain, appropriate corporate governance mechanisms should be in place to guarantee an unbiased estimation procedure.

(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.

We agree with the Bulletin that the challenge is to strike a balance in the Framework between different principles. Prudence is surely not the only or the overarching objective, but needs to be considered together with other qualitative characteristics.

The operational level for including prudence is the standards level. Evaluating the different characteristics based on particular issues is easier and more flexible than attempting to describe a particular degree of prudence at the Framework level. We observe that this is basically similar to the approach taken in the current Framework.

Prudence in the sense of caution is closely related to uncertainty of transactions and events. As a general principle, we believe that higher degrees of uncertainty of underlying transactions should be met with stronger requirements for prudence. We also note, however, that the level of prudence inherent in accounting rules sometimes affects the uncertainty of related accounting outcomes. If prudence leads to accounting rules inducing risk averse behaviour (e.g., by requiring the consideration of risk premiums for uncertain point estimates), the overall level of uncertainty declines – even if the uncertainty of underlying transactions remains unchanged. An example of prudence in this sense is the introduction of risk margins in the current ED of IFRS 4 (ED/2013/7) to reflect the uncertain characteristic of the long-term cash-flows of insurance contracts.

We also believe that similar transactions and events should be considered together. As is well known, if there is a large number of similar transactions that are not fully correlated, uncertainty for that group of assets is reduced. This issue is also relevant to the discussion of units of account.

(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?

The question about insufficient and excessive prudence in current IFRSs is hard to answer without considering the specific context, as the same rule could induce prudent reporting to a degree that might be desirable from an investors' point of view as well as reporting outcomes that would be classified as overly prudent. An example of possibly overly prudent rules is the application of provisions for onerous contracts in IAS 37 to individual performance obligations rather than to contracts as in the IASB's proposed revenue recognition standard (ED/2011/6).

The recognition of intangibles is tied to higher verification requirements than recognition of tangible assets. As – arguably – not all intangible assets are associated with a higher level of uncertainty than tangible assets, these requirements could also be regarded as being overly conservative in some cases.

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

We do not understand the discussion in paragraph 35, as prudence is not necessarily linked to sustainable financial performance. We believe that disclosures, rather than presentation, are the best way to inform users of financial statements about uncertainty and the effects of prudence. That is, we strongly agree with paragraph 37.

2. BULLETIN "RELIABILITY OF FINANCIAL INFORMATION"

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

We note at the outset that view 1 contains only three paragraphs, whereas view 2 has 11 paragraphs, which may appear to suggest a biased presentation of the arguments.

We view the modification of the qualitative characteristics in the 2010 revision of the Framework as changing the prior situation quite substantially: As noted in paragraph 7, faithful representation, i.e., a presentation that requires completeness, neutrality and freedom from error, is described as a minimum requirement for usable financial information; relevance is then maximised conditional on that. Arguably, since the degree of the faithfulness of the representation matters before relevance is even considered, it is not a simple yes or no decision, although is treated as such in the Framework. In the prior version of the Framework, in contrast, relevance and reliability were equally important and had to be traded off against each other to arrive at the best solution. Even if the IASB has identified no circumstances when recognising an asset or liability would provide information that is relevant, but does not result in a faithful representation, it is still questionable whether the two-step approach leads to a better result than the prior procedure with relevance and reliability of equal standing.

(ii) Which view do you support? Why?

A problem with the view in the 2010 Framework is, as argued above, that faithful representation has become more important than reliability, even though there are no clear-cut thresholds for faithful representation. A trade-off between these two concepts appears to address the continuous quality of the characteristic better. Therefore, we support view 2 in the Bulletin, as this view does not require a particular level of reliability or faithful representation to be present. We believe that the qualitative nature of the qualitative characteristics cannot simply be reduced by the introduction of quantitative thresholds. Specific issues can generally be solved on the standards level, and in other cases management judgment is likely to prevail.

3. BULLETIN "UNCERTAINTY"

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

We note that the discussion in this Bulletin does not consider the issue of uncertainty with respect to recognition in terms of the fundamental objectives of financial reporting. For example, we miss a discussion of how uncertainty in recognition and measurement affects the information provided in financial statements about the respective assets and liabilities.

One issue that could be addressed is that IFRS and US GAAP differ fundamentally in how uncertainty should be accounted for – either as a best estimate (in the sense of the statistical mean of possible future cash flows) or as the amount that is most likely. The typical example is a provision for a lawsuit: if only two outcomes are possible (i.e., lose a specific amount or nothing at all), the statistical mean is never equal to the future actual outcome, whereas the most likely amount occurs in more than half of the instances. The topic of recognition is obviously important to this issue as well.

We also miss a discussion of how uncertainty – or the two different views on uncertainty – could potentially translate into standards that are particularly exposed to this issue. For example, the risk margins proposed in the current ED of IFRS 4 could be used to evaluate the two views set out in the Bulletin.

(ii) Which view do you support? Why?

IAS 37 is a standard in which both views are highlighted: IAS 37.14 requires that a provision should be recognised if (a) the entity has a present obligation ..., (b) an outflow of resources is probable, and (c) the obligation can be estimated reliably. IAS 37.15 notes that if (a) is not clear, than a more-likely-than-not threshold should be used to determine whether a present obligation exists. Thus, recognition is in this case based on two judgments of uncertainty – (a) and (b) – plus another one on reliability of measurement. Next, IAS 37.36 requires the measurement to be the best estimate of the amount required to settle the obligation. It is not clear from IAS 37 whether (and how) the two probabilities (a) and (b) should affect the measurement of the provision. Presumably, the probability (b) is part of the best estimate, but probability (a) is not.

This example shows the inherent conceptual challenges of the two views presented in the Bulletin. View 1 is "cleaner" because all uncertainties are taken care of at the measurement stage, whereas view 2 can give rise to inconsistencies that can lead to difficulties in interpreting the amount of a provision.

In our view, the main counter-argument is that a strict view 1 approach leads to recognition of assets and liabilities that are highly questionable and lacking in useful meaning. We note, though, that the fundamental recognition rule for financial instruments is based on view 1, and we support this view for financial instruments, but not for other assets and liabilities. The distinction is that low probabilities of future cash flows are a fundamental characteristic of

derivatives, but less so for other assets, which are difficult to slice, unbundle, and the like.

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

We believe that different thresholds should apply for assets and liabilities. Alternatively, thresholds could be made contingent on the availability of exchange markets and the degree of verifiability.

Kind regards,

Romuald Bertl

Chairman