EFRAG

35 Square de Meeûs

B-1000 Brussels

Belgium

Paris, 17 July 2013

Dear Madam Flores,

Bulletins: Reliability, Prudence and Uncertainty

First of all, we welcome the initiative of EFRAG and the different national standard setters who have contributed to the publication of these bulletins, as we firmly believe that working on the conceptual framework must now be a priority. Recent projects developed by the IASB, as well as many issues brought to the IFRIC in recent years have shown that the foundations of IFRS need to be strengthened before one can take the evolution of IFRS further.

We also agree with the idea of reopening the discussion about "phases" that the IASB today considers closed, such as that dealing with the qualitative characteristics of reporting, but also the phase relating to the definition of the users and the objectives of the financial statements. Indeed, these two chapters are the founding pillars on which the definitions of elements of the financial statements and their measurement attributes must be constructed, ultimately leading to the definition of performance.

As reminder, our key demands about the conceptual framework include the following, some of which are being addressed in the bulletins under review: broadening the definition of the users to include businesses and long-term investors, better representation of the economic reality of transactions by placing more reliance on the concept of the observable business model, the reintroduction of the principles of prudence and reliability to preserve financial stability by reducing irrelevant volatility; the restoration to the income statement of its essential role in depicting performance over the current period.

Concerning the three bulletins, we are broadly in line with the developments and conclusions presented therein:

- Reliability, including the notions of verifiability and prudence, should be reinstated as a fundamental characteristic, with the same status as relevance.
- Prudence should also be reintroduced in the conceptual framework, as an enhancing qualitative characteristic.
- Uncertainty is not only a matter of judgement; the recognition of improbable future cash-flows does not improve financial information.

Please do not hesitate to contact us if you require any further information or explanation.

Yours sincerely,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

Prudence and reliability

We have chosen to comment on these two concepts together because we think they are closely related. We also believe that these two concepts should be explicitly reintegrated into the conceptual framework to constitute qualitative characteristics which will help in defining recognition and measurement principles. In our view the approach should be to define them in the Conceptual Framework and require that in each standard the IASB must explain how these notions have been applied or explain why in some specific cases the Board did not comply.

When the Board decided to replace the notion of "reliability" with that of "faithful representation", our main concern was the way that this "faithful representation" notion was defined. While we agreed with the "complete and free from error" characteristics, we were opposed to the "neutral" attribute which in many cases may conflict with the relevance characteristic which has been set as the first qualitative characteristic in the framework.

Indeed, this focus on neutrality has gradually led the Board to give more weight to external perspectives, relevant or not, over internal management's assessment of its business model and how it should affect the representation of economic events. Perhaps one of the most obvious illustrations is the fair value measurement attribute (especially quoted prices in active markets) that the Board judges to be more relevant information (because it is neutral, free of "management" bias). However, this "fair value" cannot depict how the entity manages its assets / liabilities through its business model in all circumstances.

This trend towards a value which the Board judges to be neutral was also evident in the proposed revision of IAS 37 (non-financial liabilities), where the Board proposed the following:

- A liability should be measured at the lowest amount possible when there is an alternative for the entity in settling its obligation (arguing that an entity would rationally choose this settlement option).
- To extend the use of expected value to measure single obligations even if a "most probable" approach is likely to provide more relevant information.
- To measure some liabilities ("service liabilities") at the amount that the entity would rationally pay a contractor to undertake the service on its behalf (even though the entity would rationally choose to carry out the service itself).

In addition, in always focusing on external data, standards often require entities to estimate (or guess) what a "market price" from a "market participant" perspective should be, thus going against the prudence, reliability and relevance characteristics.

Furthermore, this neutrality notion has been strengthened by the comparability criteria, placed first in the list of enhancing qualitative characteristics. Even though it is specified in paragraph QC23 that comparability is not uniformity, we believe that, in practice, this consideration has been ignored in many cases. We have indeed noted, especially in the IFRIC process, that the main objective pursued is to standardise the accounting methods, even if it leads to irrelevant outcomes. It is actually unrealistic to believe that financial reporting could be established on a perfect, common basis, denying all those features which are specific to the business and management, and replacing them by a perspective of a hypothetical market participant acting in a hypothetical market environment.

We therefore believe that the two fundamental characteristics for financial reporting should be "relevance" and "reliability", both applied in the context of an objectively defined and observable business model for the performance of which the entity's management will be accountable.

Thus we share the "view 2" developed in the "Reliability bulletin", that the change made to the framework in 2010, was not only a "terminology change" but that the replacement of reliability with faithful representation had weakened the importance attached to the linked ideas of measurement uncertainty and verifiability (§ 19).

Reliable information should be the information which all users could trust (i.e. on which they could rely) because the management has fulfilled its responsibility in providing verifiable and prudent data. Reliability should refer to information which is "complete and free from error" but should also encompass the notions of prudence and verifiability.

Reliability is also intended to ensure that the items recognised and measured in the financial statements have a reasonable assurance of occurring (to ensure that the financial reporting has predictive value) with a high level of confidence and verifiability. As an illustration, take the example of investments in equity instruments: the current IAS 39 allows entities to measure them at cost when there is no market price in an active market and when fair value cannot otherwise be reliably measured. We believe that such an approach is far preferable to requiring companies to make fair value measurements which are unreliable (too many assumptions and projections needed) and non-prudent (high uncertainty about the effective realisation of this value).

Concerning the notion of prudence, which we think is also encompassed in the principle of reliability; we believe that it should be explicitly mentioned as an enhancing qualitative characteristic. This principle of prudence must also be clearly articulated, particularly in connection with the treatment of uncertainties in the definition and criteria for recognition of assets and liabilities

The aim of the principle of prudence is to ensure that cash flows (negative or positive) reported in the financial statements, are the most predictable possible- that is, the most likely of occurring. The concept of prudence obviously calls upon the judgment of management but it may be properly channelled if the objectives pursued are properly defined and when prudence is applied and judged in the context of the Business Model.

We believe that prudence should, and can, be applied consistently to all items reported in the financial statements, without creating an excessive unbalance between assets (gains) and liabilities (expenses), and that, at the very least, when a single standard deals with both assets and liabilities (such as IFRS 11 or IAS 37) the same concept of prudence should be applied consistently for both. The objective of the use of prudence indeed is not only to maximise liabilities / expenses and to limit the assets / gains, but it should result in the recognition in the financial statements of what it is reasonable to expect as future cash flows. It is, in our opinion, no more prudent to recognise liabilities with a low likelihood of generating cash outflows than it is to recognise unrealised gains on financial assets, with little chance of being realised.

In conclusion, we share the opinion expressed in paragraph 19, of those who think that changing the conceptual framework in 2010 has introduced a substantive change without sufficient debate to reflect this, and that the principle of prudence should be explicitly reinstated as a qualitative characteristic.

Uncertainty

Based on the two main qualitative characteristics that we would like to promote, i.e. Relevance and Reliability, we agree with the conclusion of the Bulletin, that an uncertainty threshold should be used and maintained in the conceptual framework, to ensure that assets and liabilities recognised in the financial statements are those that are likely to give rise to future cash-flows. We therefore agree that uncertainty is not only a matter of measurement. We support the use of a probability threshold in the recognition criterion because we believe that the user of financial statements is interested in the probable consumption of resources, not in financial data which report what remains highly improbable of realisation. In our view, relaxing the recognition criterion leads to meaningless information. We therefore support the main ideas developed in view 2 of the bulletin, i.e.:

- Recognising highly improbable inflows and outflows is unlikely to provide useful information
- The measurement of such items is likely to be less reliable than that for assets and liabilities with more likely inflows/ outflows
- Using judgement to determine whether a recognition threshold has been met is simpler than making the judgements necessary to determine a measurement based on all possible expected outcomes
- Tracking, collecting, processing information for recognising elements with a remote likelihood of occurrence does not pass the cost/ benefit test.