AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

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Françoise Flores, Chair
European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
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September 30, 2013

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 on *Getting a Better Framework*, *The Role of a Conceptual Framework* and *The Role of the Business Model in 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 appreciate EFRAG's ongoing efforts to contribute to a better Framework in financial reporting, and agree on the importance of the topics brought up for discussion in the two latest Bulletins.

We do not think that the Conceptual Framework should have to be followed by the IASB in its standards development activities invariably. The Framework should provide adequate guidance for standard setting, with deviations from the Framework in a particular standard being explained in the Basis for Conclusions. Given the importance of maintaining flexibility in standard setting, we do not think that a "complete Framework" is achievable, as this would ultimately challenge the idea of individual standards.

With regard to the role of the business model, we support its use in financial reporting, agree on the tentative view that management intent and business model are distinct concepts, and think that the business model should be included in the Framework.

SPECIFIC REMARKS

1. BULLETIN "THE ROLE OF A CONCEPTUAL FRAMEWORK"

(i) Do you think the IASB should invariably follow the Framework? (Paragraphs 6-11)?

We believe that a Conceptual Framework should guide the standard setter in developing new standards and revising existing standards, and it should give the constituency a basis on which to form expectations about principles underlying future standards.

Developing a clear Framework is a difficult task, which is likely to evolve over time and needs to be amended from time to time to encompass future developments in business and the economic environment.

Therefore, we disagree with the tentative view that the IASB should be constrained by the Framework. We think that, if the IASB were to be so constrained, it would either write a Framework only in very broad terms, allowing for many alternatives that would need to be dealt with on the standards level. That would make the Framework less useful, or even insignificant. The Bulletin discusses this issue in paragraphs 17–18.

From a formal point of view, it is odd if the IASB attempts to develop a Framework to constrain itself in future years (if that is even feasible). Conceptually, the Framework is on a level below individual standards – it forms the basis on which they are developed. This is reflected in the current requirement that the Interpretations Committee must comply with the Framework, but there is no similar requirement for the IASB.

We support the view that the Framework provides a conceptual basis but must allow for flexibility in standard setting without a need to reconsider the Framework with every new standard. We suggest that the IASB should be required to explain in the Basis for Conclusions if a standard is not consistent with the Framework and the reasons for the inconsistency.

(ii) What do you think is an appropriate approach to achieve a complete Framework? (Paragraphs 15-19)

As indicated in our response to question (i) of this Bulletin, we believe that a complete Framework is unrealistic and neither achievable nor desirable. In particular, if a complete Framework really was achievable, individual standards would ultimately become unnecessary.

We agree that the IASB should think about and address cross-cutting issues. However, we believe this is best done in a research project rather than within the Framework.

(iii) Do you think the current reference in IAS 8 to the Framework as authoritative guidance is useful? (Paragraphs 23-28)

We believe the reference to the Framework in IAS 8 is useful and important to avoid recourse to standards of very different national standard setters. We particularly consider the objectives and qualitative characteristics chapters in the Framework important for issues of interpretation and analogy, on which standards are silent. The reference in IAS 8 should be retained, but updated to reflect the 2010 version, and subsequently the new Framework.

(iv) Do you think the Framework project should develop questions and decision trees or process flowcharts for developing IFRS requirements? (Paragraphs 31-32)

We agree that a formal step-by-step, decision tree or question-based approach is not useful in the Framework. It may be of assistance to users in individual standards in non-binding appendices, such as illustrative examples. A main reason is that such features suppress the need for judgment and trade-offs, and would ultimately lead to a rules-based approach that is undesirable from our point of view.

(v) How should the IASB proceed with existing IFRS in the context of a revised Framework? (Paragraphs 35-37)

We agree with the tentative view that the revised Framework should not automatically require the IASB to revise all old standards and interpretations to bring them into alignment with the Framework.

We believe that minor amendments to standards are easy and quick to do, but that substantial amendments should be dealt with in accordance with the IASB's agenda.

(vi) The Framework is not an IFRS (according to the IASB's own terminology) and it is, therefore, outside the scope of endorsement. Has this caused any issues for you in practice and, if so, how do you believe they might be addressed?

We are not aware that the scope of endorsement has caused any issues in Austria. However, we feel that this issue could become relevant if more references to the Framework were to be included in the standards. In addition, we have noted that the Framework 1989 has been displayed in the Appendix of the *Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting*, while the Framework 2010 has not yet been mentioned in official documents of the European Union (EU). Hence, as the latest amendments to the Framework are currently not playing a formal role in European law, we would very much appreciate the endorsement of the Conceptual Framework to mitigate potential conflicts of interpretation in the EU between endorsed IFRSs and the Framework.

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

No, we have no further comments.

2. BULLETIN "THE ROLE OF THE BUSINESS MODEL IN FINANCIAL REPORTING"

(i) Do you think that our assumed meaning makes sense from a financial reporting perspective?

First of all, we note that the "assumed meaning" cannot easily be identified by reading the Bulletin. We assume that the assumed meaning is described in paragraphs 11–12. The description of the business model is vague and loose, and we urge clearer definition of what the Bulletin really wants to suggest, while acknowledging that this is a difficult task (see paragraph 10).

An issue that seems underexplored in the Bulletin is the level of the business model within entities' operations, and whether an entity should define a single or several different business models. We refer to the deliberations of IFRS 9 during which the IASB proposed a third, mixed business model besides the two models contained in the current version of IFRS 9. To see the importance, consider, for example, an energy company that holds oil as inventory and decides – depending on market conditions – whether to sell it to households or use it in its own power plant to generate electricity. How would the energy company define its business model or models, and what implications would follow from that business model for measuring the inventory?

The definition of the business model is particularly important if one considers a change in the business model and its potential implications for accounting recognition and measurement.

(ii) Do you support the tentative view that management intent and business model are distinct?

As discussed in the Bulletin, there are differing opinions as to whether management intent and a business model are equivalent or distinct concepts. In most situations, management would be expected to follow the business model, so that generally the two concepts would coincide. The issue is what happens if this is not the case. Then it is difficult to distinguish between management taking an incrementally profitable opportunity that deviates from the business model, and management wanting to manage earnings; these two possibilities presumably should be dealt with differently.

Our understanding is – similar to the approach in IFRS 9 – that a business model describes the fundamental value-creating process of an entity, whereas management intent relates to specific transactions. Using the business model approach instead of management intent attempts to reduce management's ability to manage earnings just by changing its intent. This potential for earnings management is discussed in paragraph 29, and it is surely a concern. However, we note that there are other accounting issues that seem to cause more concern about earnings management, e.g., the estimation of level 3 fair values.

We therefore support the tentative view that management intent and business model are distinct, and that the business model is a stable description of how the company adds value through its activities.

We also agree that a description of the business model has become increasingly important in communication with users as a result of recent initiatives, such as integrated reporting.

(iii) Do you support the tentative view that the business model should play a role in financial reporting?

We emphatically agree that the business model should play a role in financial reporting. We particularly agree with the analysis in paragraphs 15–27 that the business model provides relevant information, whereas information based on “objective” criteria, such as fair values, provide fictitious, “as-if” information that is generally less useful in predicting future cash flows from the entity’s operating activities.

(iv) Do you support the proposed implications for the IFRS literature?

We strongly support the view that the business model should be included in the Framework. As stated in the Bulletin, the business model view has a number of important consequences for selecting recognition, measurement, presentation, and disclosure principles.

In this regard, we find it unfortunate that the IASB did not include a substantial discussion of the business model in the main chapters of the Discussion Paper on the Conceptual Framework of July 2013, but points to it only in a few instances without exploring it rigorously. Hence, we find it helpful that the Bulletin sparks a discussion of this issue.

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

No, we have no further comments.

Kind regards,

Romuald Bertl

Chairman