

Ms Françoise Flores
Chair of the
European Financial Reporting Group (EFRAG)
35 Square de Meeûs
B-1000 Brussels
Belgium

Ref
F 2

Phone extension
-5430

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EFRAG's Draft Comment Letter on the IASB's Discussion Paper DP/2013/1 "A Review of the Conceptual Framework for Financial Reporting"

Dear Ms Flores

As the German Insurance Association (GDV) we welcome and appreciate the opportunity to comment on your Draft Comment Letter regarding the IASB's Discussion Paper DP/2013/1 "A Review of the Conceptual Framework for Financial Reporting" ("DP") published by the IASB on 18 July 2013.

From the GDV's perspective the review undertaken by the IASB is an important step towards an updated Conceptual Framework being of strategic importance for future design and material direction of IFRS accounting standards and their interpretation/application. The currently ongoing deliberations on the conceptual level might also have a significant impact on the current major projects as the insurance contracts project (IFRS 4 Phase II) or the project on accounting for financial instruments (IFRS 9), and vice versa.

In general, the GDV considers the proposals in the IASB's DP as a suitable starting point to develop a consistently designed Conceptual Framework being a stable conceptual basis for IFRS Standards for a foreseeable future. We request EFRAG to encourage the IASB to continue its appreciated efforts towards finalisation of the project in line with the Board's self-commitment regarding the timeframe from September 2012 (i.e. until September 2015). We are committed to accompany both EFRAG and IASB in further stages of this important project.

However, we are not fully aware about the intended and unintended implications for the requirements of the existing standards and are deeply concerned about a potential state of constant changes. We believe that such an inconvenient situation should be avoided as an extended period of calm is indispensable after the 'major IFRSs' projects get finalised soon.

**Gesamtverband der Deutschen
Versicherungswirtschaft e. V.**

German Insurance Association

Wilhelmstraße 43 / 43 G, D-10117 Berlin
Phone: +49 30 2020-5000
Fax: +49 30 2020-6000

51, rue Montoyer
B - 1000 Brussels
Phone: +32 2 28247-30
Fax: +32 2 28247-39

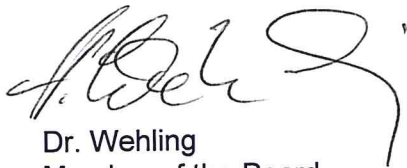
E-Mail: h.saeglitz@gdv.de

www.gdv.de

In advance of our detailed comments we would like to explicitly express the GDV's continuous support for the considerable efforts undertaken by EFRAG and its close exchange with the involved European national standard setters to reach a consistent common European view on such an important issue as the Conceptual Framework for IFRS. We do acknowledge that it requires immense compromise efforts as the divergence of traditional conceptual views in Europe is commonly known. Nevertheless, we feel confident that all the efforts will lead to a successful outcome and a beneficial European contribution towards IASB.

We hope that our detailed comments will be helpful to EFRAG Technical Expert Group's members in reaching final conclusions on the DP/2013/1. If you would like to discuss our comments in more detail we would be very delighted.

Yours sincerely,



Dr. Wehling
Member of the Board
German Insurance Association



Saeglitz
Head of Accounting
German Insurance Association

General comments:

The GDV has the strong view that the revision and update of the '**Conceptual Framework**' is a project of **strategic importance for IFRS accounting with far-reaching consequences**. Especially the future role of fundamental accounting principles (e.g. prudence principle) and the conceptual design of measurement and presentation approaches might be decisive for the interaction between the Conceptual Framework and the specific standards or current standard projects, and vice versa. *For example*, the suggested introduction of current measurement in the statement of financial position for insurance contracts (IFRS 4 Phase II) and the proposed presentation of some related current value changes in the statement of comprehensive income are of utmost importance for insurers. Furthermore, the inherent interaction between the proposed accounting provisions for insurance contracts accompanied by the limited amendments regarding accounting requirements for financial instruments (IFRS 9) might demonstrate the crucial importance of the consistent use of other comprehensive income (OCI) presentation approach to avoid economically inappropriate volatility in the statement of profit or loss. In addition, the existing provisions for pension accounting (IAS 19) or the availability of the revaluation method for intangible assets (IAS 38) as well as for property, plant and equipment (IAS 16) demonstrates that the use of OCI is a generally important issue which needs to be addressed on conceptual level in an appropriate way. A sound conceptual basis for the use of OCI presentation might ensure its consistent application; increase its understandability and thus the considerable benefits of its use.

The GDV continues to highlight the essential importance of an appropriate presentation in profit or loss statement for German insurers. Thus, any conceptual approaches for OCI solution needs to be verified how they address the widely shared concern of long-term oriented insurers regarding the economically inappropriate volatility in primary performance reporting, i.e. in the profit or loss statement. Especially, we believe that the **conceptual basis for use of OCI presentation shouldn't be defined too narrow to avoid any artificial constraints and immediate inconsistencies** when defining appropriate specific accounting provision at a standard level. Although we tend to share the EFRAG's tentative view and might support the 'broad approach' of the IASB's DP (paragraph 373) we also believe that an appropriate **conceptual basis for the profit or loss presentation should be defined**; e.g. the recognition of items in profit or loss statement might refer to realisation principle. But profit or loss might also need to include e.g. short term trading activities where the reinvestment risk is (inherently) considered. An understandable conceptual approach based, in general, on a single principle (i.e. realisation principle) would **allow the IASB to give up the artificial categorisation approach** as proposed in the IASB's DP. In addition, the same principle might be suitable to drive the 'recycling' recognition. We fully acknowledge that the use of realisation principle for recognition of items in profit or loss might require suitable impairment requirements. Nevertheless, as a matter of

principle we have the strong view that **recycling** needs to occur, at latest at the moment of disposal (e.g. of equities measured at FVOCI).

Irrespective of the future underlying conceptual basis the IASB might agree on, the OCI presentation for insurance contracts and underlying financial assets is an integral and essential element to achieve a meaningful and transparent presentation of underlying business model. In particular, regarding the role of OCI presentation within the alternative industry approach for insurance contracts with participating features we refer to our previous comment letter to you (as of 18 October 2013). Especially, we have the strong view that the income statement should reflect the long-term nature of insurance business model **reporting only realised returns for services provided** where the changes in expected future profits would be transparently reflected and presented in contractual service margin on the face of balance sheet. Thus, the related fair value changes of underlying financial assets need to be reported in OCI only and should not destroy the profit or loss presentation until the moment of realisation.

The interaction of the Conceptual Framework project with current major IFRS's projects and a need for an extended period of calm

The GDV strongly supports the finalisation of major IFRS's projects, i.e. we would especially oppose further significant delays of the insurance contracts project (IFRS 4 Phase II). But we also heavily advocate for an **extended period of calm** to allow entities for collection of practical experience with new standards before adjusting them once more for conceptual reasons only. For those reasons we do not share the criticism of EFRAG when it states that "*many of the principles proposed have been generated from the requirements in current Standards without their justification being debated conceptually*" (page 1). This view might neglect the matter of fact that the Board deliberated many of the proposed concepts (e.g. the use of OCI presentation for insurance contracts for changes in discount rates only) in a very deep and intensive way which would never be feasible on a theoretical-conceptual level only. The GDV highly appreciates that the IASB decided to explicitly utilize the insights it has gained in the four major projects for the conceptual discussions on Conceptual Framework. Nevertheless, we share the EFRAG's view that the revised Conceptual Framework will and should have implications for financial statements in the long-run (page 4). Thus, in general, we do support the implicit request for consistency.

However, although the GDV supports the consistency between the concepts of the future Conceptual Framework and the provisions of specific standards, the GDV is deeply concerned if the major projects will be reopened again after just being finalized in near future what we assume. An extended period of calm is **indispensable**.

The suggested objective of the future Conceptual Framework

The GDV is concerned that the suggested revision of the currently existing Conceptual Framework might lead to increased confusion regarding the interplay between the updated and amended conceptual basis of IFRS accounting and the specific IFRS. Thus, we **oppose the proposed change regarding the objective** of the future Conceptual Framework. From our perspective the final Conceptual Framework should be also developed from a perspective as a valid basis for understanding, interpretation and application of principle-based standards' requirements, which are developed in agreement with the conceptual provisions to the extent possible. In addition, we think that the suggested change for the role of the Conceptual Framework might underestimate its importance for preparers and be not in line with the explicit reference in IAS 8 paragraph 11. We believe that it is more important and sufficient to clarify the objective of IFRS accounting.

The role of prudence, reliability and stewardship

We share the EFRAG's view that the reliability principle and stewardship as equivalent objective of financial reporting should be explicitly reintroduced into the Conceptual Framework. We also believe that the prudence principle should be included explicitly into the Conceptual Framework as well and not only implicitly built into IFRS standards (paragraph 395).

- Regarding prudence principle

Within EU the new Accounting Directive (2013/34/EU) contains an explicit reference to prudence principle (Recitals 9, 22 and Article 6 paragraph 1 (c)). Thus, from the European perspective, an explicit inclusion of prudence concept into the Conceptual Framework might avoid potential future endorsement controversies if the underlying conceptual basis for IFRS standards does not include a similar principle in an explicit way. In addition, the IASB continues to communicate that e.g. the concept of prudence is reflected implicitly in the current standards. Thus, it might be more appropriate to conceptually clarify how this concept should be understood and used in IFRS accounting than just deleting it from the Conceptual Framework and keeping its material relevance with the standards at the same time. In particular, we believe that it is essential to clarify if and how the concept of prudence should influence the application of recognition and measurement provisions. Only a common understanding will increase the understandability and prevent any confusion with regard to this important principle. *For example*, we would suggest encouraging the IASB to clarify how the currently preferred concept of neutrality on the level of Conceptual Framework interferes with the new 'expected credit loss model' implemented within IFRS 9 for debt instruments being not measured at full fair value approach. Does the new expected credit loss model replace the use of prudence as an underlying principle or shall the expected credit

loss model be, in addition, applied in a prudent way to prevent further “too late, too little”-outcome in practice. Or is ‘expected credit loss model’ reflecting a regulatory concept of prudence which might be not in line with the objective of IFRS financial reporting?

Thus, we believe that ‘**concept of prudence**’ **needs to be considered explicitly** in the Conceptual Framework as a fundamental accounting principle. We urge the IASB to provide sufficient clarification on its intended use in IFRS accounting practice.

- Regarding reliability principle

The GDV is deeply concerned that the principle of the reliability should not be referred to as an explicit notion/qualitative characteristic of IFRS accounting any more. We are concerned especially with regard to long-term consequences of its removal and faithful presentation considered by the IASB to be sufficient as constraint for future conceptual considerations. In addition, we would consider the IASB’s view inappropriate if the intended meaning of reliability principle should be seen incorporated within the concept of faithful presentation only. Especially, the accounting for intangible assets demonstrates the crucial relevance of reliability principle where the concept of faithful presentation might even require the recognition and current measurement of all identifiable items, including the internally generated goodwill (e.g. IFRS 3).

Thus, we believe that ‘**reliability**’ **needs to be considered explicitly** in the Conceptual Framework as a fundamental accounting principle. We consider it crucial for IFRS accounting framework being intended to provide decision useful information to explicitly refer to reliability as a conceptual concept for accounting requirements.

The essential role of business model in accounting

We share the view that **business model** should play an **essential** role in defining of accounting provisions as different measurement of similar items might be necessary when considering different business activities or circumstances (e.g. mixed measurement model in IFRS 9 *Financial Instruments* which we support).

Similarly, *for example*, it is not appropriate to treat every option or guarantee as a stand-alone derivative and to recognise the time value changes immediately in profit or loss statement. In particular, in our view, the options and guarantees embedded in insurance contracts represent also a future service to policyholders which is also reflected in the contractual service margin. Thus, changes in value of options or guarantees might be better offset against changes in the contractual service margin when existent. This specific example demonstrates that explicit consideration of specific circumstances is **essential to achieve an understandable picture of financial performance in financial reporting** and ensure a faith-

ful presentation of financial position of an entity. In addition, this examples demonstrates that we do share the EFRAG's view that measurement in the statement of financial position cannot be considered in isolation, and it is essential to consider how the remeasurements are presented in the financial statement (page 2), i.e. amongst others in the statement of comprehensive income (profit or loss and other comprehensive income). We also agree that "*the Conceptual Framework should not artificially limit the IASB's possibilities for defining the primary performance to be reflected in profit or loss*" (page 2). Thus, a high level principle-based approach only is most suitable to approach this important issue in the Conceptual Framework.

However, we miss in the IASB's DP and in the EFRAG's Draft Comment Letter an explicit consideration of how to ensure an **aligned accounting treatment of a business model** where two or more different non-industry specific standards apply and their **consistent interaction is essential** to achieve a meaningful financial performance presentation without neglecting the need for an appropriate presentation of financial position (e.g. in case of long-term oriented insurers having to apply current measurement model on liability side (IFRS 4 Phase II) and a mixed measurement model on the asset side (e.g. IFRS 9, IAS 40)). We explicitly acknowledge and support the comment in paragraph 263 of the EFRAG's Comment Letter which however only raises the danger of potential creation of 'measurement inconsistencies'. We encourage the EFRAG to accompany and support the IASB in related efforts and activities as it already happens nowadays. We appreciate the EFRAG's outreach activities and EFRAG TEG discussions regarding the need for holistic accounting solutions for long-term investment business models (i.e. *liability-driven* versus *asset-driven* business models) as a useful conceptual contribution which results might be utilised by the IASB in due course. In particular, insurers appreciate these conceptual considerations as they are deeply concerned, because unaligned accounting provisions, thus not taking asset-liabilities management strategies into account, might lead to significant accounting mismatches.

Definition of assets and liabilities

The GDV supports further clarifications regarding the new definition of assets and liabilities to achieve a sound conceptual basis for consistent specific requirements at a standard level. Although we acknowledge and in general support the Board's rationale for the suggested adjustments we are however concerned about potential unintended consequences of the proposed changes. In addition, we especially believe that the current IASB's proposal is mixing the definition of an 'asset' as such with the subsequent question of its recognition and the ownership. These two questions are independent. Thus, we disagree with the EFRAG's position in paragraph 19 and strongly suggest removing the reference to 'control' within the asset definition. Nevertheless, we do believe that the meaning

of 'control' should be addressed at the level of Conceptual Framework as intended by the IASB (DP, paragraph 3.16).

Furthermore, we explicitly support the EFRAG's view with regard to the need for further testing if the proposed changes in asset and liability definition might be interpreted consistently (paragraph 18).

Recognition

Although we acknowledge the rationale of the IASB we do strongly believe that the probability threshold within recognition criteria for assets and liabilities should be retained on the level of the Conceptual Framework. This might better insure the consistency of future decisions on the standards level. In addition, for pragmatic reasons we do not share the view that probability considerations should be taken into account at measurement level only.

Measurement

The objective of financial statements is to provide reliable information about financial position and financial performance of the reporting entity where especially the accounting presentation of financial performance, from our perspective, should be in line with the underlying business model and related business activities. We share the IASB's preliminary view that the Conceptual Framework should not recommend measuring all assets and liabilities on the same basis as assets might not contribute to future cash flows in the same way and liabilities might be settled or otherwise fulfilled depending on the underlying business model. Thus, we strongly **support the mixed measurement approach** which includes the use of cost-based measures and current measurement approaches (e.g. current market prices or current fulfilment values) when appropriate. We think that the "appropriateness decision" regarding the measurement basis should be taken at the standard level only.

However, we do agree with the IASB's preliminary view that the number of different measurement basis used should be **limited** to the smallest number necessary to provide relevant information. Thus we would disagree with the EFRAG's tentative conclusion in the paragraph 268.

In addition, we are also supportive of the IASB's preliminary view that when selecting the measurement approach to use for a particular item, the IASB should consider what information will be provided to users in both the statement of financial position and the statements of profit or loss and other comprehensive income. Thus, we widely agree with EFRAG's observations in paragraph 281-286. In this context we would like to highlight however the **predominate importance of appropriate information provided to users by profit or loss** statement. Thus, a **conceptual rationale** based on sound principles **for profit or loss recognition** should be developed. As expressed above we suggest using the **realisation**

principle which would allow aligning the presentation within income statement for cost-based measurement *and* current measurement approach combined with use of OCI presentation (including requirement for recycling as a matter of principle).

Presentation: predominate rule of performance reporting

Although we agree that 'primary financial statements' should be looked at together we strongly continue to believe that **profit or loss** statement (income statement) has a **special meaning for investors and other users**. Thus, we do disagree with the **IASB's view** that no primary financial statement should have primacy. It **denies the matter of fact**. Especially the discussions regarding an appropriate presentation of financial performance of long-term oriented business models (e.g. of insurers) proved this. We are fully aware that constituents who favour 'full fair value accounting' approach prefer the focus on balance sheet and treat the profit or loss account as storage of remeasurement changes in assets and liabilities. We disagree with such an approach as we believe that current measurement leads in many cases to significant and inappropriate volatility in earnings which does not provide useful information about the underlying economic performance of entity and leads to too much focus on short-term and/or market-driven volatile results. Thus, we prefer a robust accounting approach which allows for **transparent presentation of underlying economic performance without market noise** in income statement. The **OCI presentation** can be utilized for this purpose.

The essential importance of OCI presentation

We strongly agree with EFRAG's tentative position (paragraph 346 - 348) and also support the preliminary IASB's view that the Conceptual Framework should require *profit or loss* to be presented as 'total'. The main objective of profit or loss presentation should remain to reflect the real underlying entity's performance. The GDV continues to argue that the **short-term volatility** created by current measurement for items of statement of financial position might **not be useful for users** of insurers' financial statements and therefore decrease the quality of financial reporting by overwhelming the results of the operating business. Furthermore, we share the tentative view of EFRAG that profit or loss total has more predictive value than total comprehensive income (paragraph 348). We do think that **use of profit or loss and OCI presentation creates an added value for users** of financial statements as it explicitly identifies decisive components of the return and provides transparent information about the other influences. Artificial limitations on the use of OCI presentation should be avoided; thus we tend to support the EFRAG's view (paragraph 373).

An appropriate presentation in profit or loss statement is essential for insurers; but also the interaction with the regulatory participating rules needs to be taken into account when contracts with participating features are considered. Only a comprehensive and robust approach will allow the

IASB to address the widely shared concern of long-term oriented insurers regarding the economically inappropriate volatility in performance reporting in the profit or loss statement when applying the Board's accounting approach resulting in current measurement of insurance contracts in the statement of financial position.

However, we have the impression that the IASB's DP is trying to justify the decisions taken on important projects in last time rather than defining a conceptually sound and understandable basis for use of OCI presentation. Furthermore, we believe that the **conceptual basis for use of OCI presentation shouldn't be defined too narrow to avoid any artificial constraints** and immediate inconsistencies when defining appropriate specific accounting provision at a Standard level. Although we tend to share the EFRAG's tentative view and might support the 'broad approach' of the IASB's DP (paragraph 373) we also believe that an appropriate **conceptual basis for the profit or loss presentation should be defined**.

From the GDV's perspective, conceptually the '**dividing line**' between profit or loss and OCI presentation should be principle-based and refer to the **realisation principle**. We are aware however that appropriate impairment rules should supplement this approach. In addition, we acknowledge that there are cases in which profit or loss recognition might be more appropriate even before the realisation as it might better reflect the underlying business model (e.g. trading activities with stand-alone derivatives). Especially profit or loss might also need to include short-term trading activities where the reinvestment risk is (inherently) considered. Thus, we tend to agree with EFRAG's tentative view that the Conceptual Framework should not artificially limit the Board's possibilities for defining the items which should be presented in profit or loss. However, the realisation principle should be the main principle to follow. In addition, we agree that the use of OCI presentation should be limited to effects of re-measurements, i.e. changes in current measures of assets and liabilities (paragraph 362).

An understandable conceptual approach based in general on a single principle (i.e. realisation principle) would allow the IASB to give up the **artificial categorisation approach** as proposed in the DP. Especially, the creation of certain categories proposed by the DP ("*bridging item*", "*mismatched remeasurements*" and "*transitory remeasurements*") might be not in line with the principle-based approach as expected by the constituents for the future Conceptual Framework. Nevertheless, we appreciate the systematic survey regarding the current use of OCI presentation as it demonstrates its established importance in IFRS.

In our strong view, '**recycling**' is an inherent and essential part of the **OCI presentation approach** which as a matter of principle should always be required unless impractical. 'Clean surplus accounting' as a theoretical concept provides a rationale for that request. Furthermore, we disagree

with the tentative conclusion of EFRAG that recycling should not be required when it would not provide relevant information (paragraph 354). As expressed above, we believe that a decisive principle for the moment of recycling should be the realisation principle. Furthermore, in some important cases (e.g. insurance contracts) recycling occurs automatically as discounting effects revert over time. We fully acknowledge that the use of realisation principle for recognition of items in profit or loss might require to be supplemented by appropriately designed impairment provisions. Nevertheless, we have the strong view that recycling needs to occur, at latest at the moment of disposal (e.g. of equities measured at FVOCI).

Accounting for stable long-term oriented business models and the use of OCI presentation

Any accounting requirements should consider the specific characteristics of long-term oriented business models. Thus, accounting requirements have to allow for appropriate consideration of the underlying business model to avoid unintended consequences, i.e. full fair value approach and market noise in profit or loss statement is not in line with stable insurers' business model. In addition, unintended negative consequences for long-term investments and stability of financial system should be avoided. The decisions taken by the Board for the insurance contracts project or for financial instruments project demonstrate that the consequences of the current measurement in the balance sheet for the recognition of current value changes in the statement of comprehensive income are taken into account. This is appreciated by the GDV as it allows for transparent presentation of financial position in the balance sheet and appropriate presentation of financial performance in the income statement. Both effects are equivalently important and should be considered together. It turns out that the use of OCI presentation is essential to achieve this outcome in a current valuation environment.

The GDV continues to support the **both-side approach** for consistent OCI presentation, which has also been debated in depth on conceptual level at EFRAG recently. Only consistent consideration of inherent interaction between assets and liabilities can ensure that an acceptable solution without artificial accounting volatility can be developed. We share many observations as expressed in the EFRAG's letter towards IASB and European Commission on long-term investment business models in financial reporting (both as of 25 October 2013). We expect that IASB will take this contribution into account deliberating the Conceptual Framework and especially the role of business model in accounting.

Disclosure

Reporting financial information imposes significant costs on preparers. It is essential that those costs being a considerable burden for preparers are justified by the benefits of reporting that information to users. The GDV especially appreciates the efforts of the IASB to address these concerns

regarding the continuously growing disclosure requirements being developed by the IASB on a standard-by-standard-basis. The '**information overload**' is a very important issue which needs to be addressed on a short-time basis. We support the suggested more explicit clarification regarding the use of materiality concepts for the notes and the envisaged development of a principle-based disclosure framework in the next step. We widely support the related comments of EFRAG with regard to this aspect.

Indeed, for the successful outcome of the efforts related to the future Conceptual Framework it might be decisive to address the 'information overload' issue. We believe that is crucial to define what the **objective of the notes** within an IFRS reporting package is. This would allow specifying the relevant disclosure requirements. We believe that the main purpose of notes is to supplement the primary financial statement by providing additional information. Respecting the decision that IASB does not require a 'management report' we believe that 'forward-looking information' or related sensitivity analysis likewise forecasts should also not be required in the notes.

In particular, we wonder that the IASB's DP proposes to require the disclosure about the nature and extent of the entity's unrecognised assets and liabilities. Also regarding the requirement to disclose different kind of disaggregation, roll-forwards etc. we believe that an explicit commitment to consider the cost/benefits constraint and materiality principle is necessary. We share the EFRAG's doubts if proposed considerations would introduce sufficient discipline regarding definition of future disclosure requirements.

The main reason for the information overload is created by the fact that interconnections between requirements of different standards containing disclosure requirements are not sufficiently considered. We think that there should be created a **single disclosure standard** which might contain a principle-based disclosure framework (including the suggested 'communication principles') and minimum disclosure requirements.

In addition, the requirements should consider different environments in which the entities are operating. For example, **insurers are highly regulated**. Thus, any additional burden with regards to disclosures should take into consideration what kinds of information are already available from other sources (e.g. regulatory disclosure requirements).