Finance for Europe

14 January 2014

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Submitted via the "Comment on a Proposal" page at www.ifrs.org

Discussion Paper DP/2013/1 A Review of the Conceptual Framework for Financial Reporting

Dear Sirs,

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to comment on the International Accounting Standards Board's (IASB) Discussion Paper DP/2013/1 A Review of the Conceptual Framework for Financial Reporting ("the DP").

We note the letter from the International Swaps and Derivatives Association (ISDA) dated 14 January 2014 on the DP. AFME members broadly support ISDA's general comments on the DP and its responses to the specific questions for respondents as summarised in Appendix H of the DP. Further to the above, AFME's members have the following specific comments on the DP:

Derecognition (Question 9)

Like ISDA, our members disagree with the IASB's preliminary view on derecognition, which concludes that a control approach, as described in paragraph 4.36(a) of the DP, should be applied.

For financial assets, the control approach advocated by the IASB in the DP is inconsistent with the current derecognition model applied in IAS 39 (and

[1] The Association for Financial Markets in Europe (AFME) represents a broad range of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks and other financial institutions. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

IFRS 9), which continues to adopt what is primarily a risk and rewards approach, with a control based overlay that applies only if the risk and rewards analysis is inconclusive.

The derecognition model for financial assets was subject to a review in 2009, in the context of a proposal to move to a control based model. However, the general consensus from that project, following extensive consultation and full due process by the IASB, was that the existing derecognition model in IFRS was more appropriate than a pure control based model, and consequently it was decided not to change the existing IFRS model.

Thus, based on the above, although we accept that there may be circumstances where the conceptual framework will be inconsistent with current accounting standards, we do not believe that it is appropriate to introduce concepts that are at odds with the existing guidance in IFRS for such wide scale topics as derecognition, particularly where the prevailing guidance has recently been affirmed following a thorough review by the IASB and its constituents.

Therefore, in our view, the IASB should restrict its guidance on derecognition in the Conceptual Framework to a high level principle that would accommodate both a risk and rewards based and a control based model. Any change to the existing model with a view to developing a more control based approach should be undertaken as a standards level project with full due process and consultation with constituents.

Definition of equity and distinction between liabilities and equity instruments (Question 10)

Our members agree with the IASB's preliminary view that the Conceptual Framework should retain the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities and that it should state that the IASB should use the definition of a liability to distinguish liabilities from equity instruments.

Our members also agree with the IASB's preliminary view that if an entity has issued no equity instruments, it may be appropriate to treat the most subordinated class of instruments as if it were an equity claim, with suitable disclosure. We further agree that identifying whether, and if so, when, to use this approach based on identifying the most subordinated class of instruments would be a standards level decision to be made when developing or revising particular standards, rather than a matter to be addressed in the Conceptual Framework.

Notwithstanding the above, we endorse the comments made by ISDA in their letter to the IASB. In particular, we agree with ISDA that it would be inappropriate to adopt the narrow equity approach outlined by the IASB in paragraph 5.30 of the DP, since many classes of instrument have the commercial characteristics of equity without being the most subordinate class of instruments.

Moreover, for similar reasons to those outlined in ISDA's letter, we disagree with the strict obligation approach outlined by the IASB in paragraph 5.34 of the DP. In particular, for the reasons outlined in paragraphs BC10 to BC 15 of IAS 32, our members believe that permitting an entity's shares to be used as a currency while achieving equity classification for such instruments would not improve accounting, as it would then be possible for almost any obligation to be recorded as equity simply by requiring it to be discharged in a variable number of the entity's own shares.

Thus, in summary, although our members believe that it is important for the IASB to address the definitions of equity and liabilities and the distinction between them in the Conceptual Framework, we believe that any such definitions should be restricted to high level conceptual principles. In our view, the Conceptual Framework project is not the appropriate forum in which to develop or determine specific approaches to distinguishing between equity and liabilities, such as the narrow approach or the strict obligation approach outlined in the DP. We believe that if either of these approaches, or any other alternatives, are to be further developed in detail, this should be done in the form of a separate standards level project.

Further, in light of the consultation on financial instruments with the characteristics of equity in the IASB's joint project with the US Financial Accounting Standards Board (FASB), which was suspended in 2010 without developing a satisfactory and universally accepted approach to accounting for such instruments, our members believe that, as noted in our letter to the IASB dated 30 November 2011 on its Agenda Consultation, this matter could be most effectively addressed by making appropriately targeted amendments to IAS 32.

Presentation in the statement of comprehensive income – profit or loss and other comprehensive income (Questions 19 to 21)

Our members view an entity's profit or loss as a key financial metric that is globally recognised and understood, and therefore support the IASB's preliminary view that the Conceptual Framework should require profit or loss to be presented as a total or sub-total in the financial statements. Like the IASB, we believe that the reasons for retaining this measure, as outlined in paragraph 8.20 of the DP, outweigh the arguments for not retaining it as outlined in paragraph 8.21 of the DP.

Our members also agree with the IASB's preliminary view that the Conceptual Framework should require the recycling of some gains and losses from other comprehensive income (OCI) to profit or loss when they are realised or at a time specified by particular standards. As noted in paragraph 8.24 of the DP, our members believe that recycling protects the integrity of profit or loss as the primary source of information about an entity's return on its economic resources and provides users of financial statements with relevant information about a transaction or event (e.g. realisation or settlement).

In this context, like ISDA, we strongly support the concept of cash flow hedge accounting, with gains and losses initially recorded in OCI and subsequently recycled to profit or loss when the hedged item affects profit or loss. Further, as noted in previous correspondence including our letter to the IASB dated 27 March 2013 on the proposed amendments to the classification and measurement requirements in IFRS 9, we also believe that where gains and losses on an entity's issued debt instruments arising due to changes in its own credit are realised, then these amounts should also be recycled from OCI through the profit and loss account.

Overall, our members support a combination of Approach 2A, the narrow approach and Approach 2B, the broad approach to determining which items are to be included in OCI. However, like ISDA, we believe that the IASB should seek to find a more conceptual basis for the use of OCI than the principles outlined in the DP. We further agree with ISDA that, in general, an item in OCI should be recycled through profit or loss if the OCI amount is realised externally through, for example, a sale or the occurrence of the hedged cash flow in cash flow hedge accounting.

Additional guidance to support the asset and liability definitions (Questions 5 to 7)

With regard to constructive obligations, our members agree with retaining the existing definition, which encompasses both legal and constructive obligations rather than narrowing the definition to include only liabilities that are enforceable by legal or equivalent means. However, we also endorse ISDA's comments in relation to the proposed guidance in paragraph 3.50 of the DP and would similarly oppose the introduction of this guidance if it were to mean that a restructuring provision would not meet the criteria for a constructive obligation.

With regard to the meaning of 'present' in the definition of a liability, our members, like ISDA, believe that an entity should recognise a liability which it has no practical ability to avoid and therefore support view 2 as outlined in paragraphs 3.77 to 3.81 of the DP.

Notwithstanding the above, we note that the IASB has a long-running project on IAS 37, Provisions, Contingent Liabilities and Contingent Assets, which has not clearly resolved the many issues relating to present obligations and other similar matters, despite extensive discussions and broad consultations. We therefore believe that the IASB should avoid seeking to establish definitive guidance on such matters through the Conceptual Framework project where it has been unable to resolve such issues through the more thorough review and consultation inherent in the due process associated with a standards level project.

Paragraph 3.112 states that "...Strictly speaking, trade date accounting is inconsistent with the concepts discussed in the Discussion Paper..." However, the DP does not further address this inconsistency nor seek to resolve it. Given that trade date accounting is widely used amongst banks and other financial institutions, and is considered to provide reliable and relevant information for users of financial statements, we believe that this issue should be further addressed and that the IASB should seek to resolve it as it seems implausible that a Conceptual Framework can be established that is inconsistent with such a widely used and accepted principle.

Presentation and disclosure (Question 18)

Our members agree with the IASB's preliminary view that it should consider the communication principles set out in paragraph 7.50 of the DP when it

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develops or amends disclosure guidance in IFRSs, and therefore consider that the communication principles in paragraph 7.50 should be part of the Conceptual Framework.

As noted by ISDA, there is a considerable amount of 'disclosure overload' in current financial reporting, which is both onerous for preparers from a compliance perspective and may risk the more important disclosures being obscured. We believe that these issues could be partially addressed by introducing the communication principles outlined in the DP. However, as noted in our letter to the IASB dated 30 November 2011 on its Agenda Consultation, we also believe that a framework for disclosure, comprising a set of principles against which the proposed disclosure requirements of each new or modified IFRS could be measured, should also be established through a separate project similar to the FASB's disclosure framework project. Notwithstanding this, we continue to believe that disclosures should be established primarily in individual standards and would not support the development of a separate IFRS on disclosure.

We would be pleased, of course, to further discuss the issues covered in this letter or to provide further information about any of the matters which our members have raised if that would be helpful.

Yours faithfully,

Richard Middleton
Managing Director Tax & Accounting
AFME