European
Banking
Federation

Chief Executive

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Mr Hans HOOGERVORST
Chairman
International Accounting Standards Board

Email: hhoogervorst@ifrs.org

Subject: EBF Comment Letter on the IASB Exposure Draft 'Conceptual Framework for Financial Reporting'

Dear Mr Hoogervorst,

The European Banking Federation (EBF) is grateful for the opportunity to comment on the Exposure Draft (ED) 'Conceptual Framework for the Financial Reporting'. We also take the opportunity to express our continuing support to the IASB to improve the framework as we consider the project very important for the whole standard setting process.

The EBF agrees that the main purpose of the Conceptual Framework (CF) is to assist the IASB in developing standards that are based on consistent concepts. We note that there are several areas e.g. measurement basis, derecognition, performance reporting where the CF is not definitive and suggests that solutions will need to be developed at the standards level. While we do not disagree with this approach, we note that, to meet the objectives of the CF, the IASB will need to compare the conclusions in these areas across standards and be clear why these are the same or different.

The EBF has focused its comments on the following aspects of the ED:

PRUDENCE

The EBF response to the 2013 Discussion Paper (DP) noted that it was not necessary to reintroduce prudence in the CF, whilst if it were to be done, it would be necessary to clearly define it and differentiate it from the regulatory concept of prudential reporting. Nevertheless, the EBF can accept prudence being included in the CF and defined as the exercise of caution when making judgements under conditions of uncertainty.

However, we agree that the concept should not be extended to include 'asymmetric prudence'. We would strongly object to asymmetry being an overarching concept. Such an inclusion would introduce bias into standard setting, where it would be assumed that gains and losses and assets and liabilities would be treated differently in all circumstances to the detriment of meeting the objectives of financial reporting in terms of providing relevant information that faithfully represents the transactions and economic situations. We agree asymmetry may be appropriate in particular situations, which are best determined at the standards level.

For example, IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' requires different recognition thresholds for contingent liabilities and contingent assets and IFRS 15 'Revenue from Contracts with Customers" requires variable consideration to only be recognised a revenue to the extent it is highly probable that it will not reverse. Therefore it is clear that accounting standards can be developed that include asymmetry when it is assessed to be appropriate in a particular situation. However, it may be that the reasons for this can be better expressed. Alternatively, a small minority of the EBF consider that including asymmetry in the definition of prudence could also serve to clarify standards development in some circumstances.

OTHER CHANGES IN WORDING

The EBF is content with the inclusion of references to 'stewardship' and 'substance over form'. However, we note that paragraph 4.54 may be inconsistent with IFRS 9 in suggesting that implied contractual terms are taken into consideration in assessing the substance of the contractual rights and obligations unless they have no commercial substance.

The determination of whether a contract contains solely payments of principal and interest is based on the contractual terms and, in particular, the instrument E example in B4.4.13 makes it clear that legislative powers that are not contractual terms of the financial instrument are not included in the assessment. It may be that further consideration needs to be given to how 'substance over form' interacts with accounting based on financial instrument contracts.

In addition, we note that the idea that users should have a reasonable knowledge of accounting is proposed for deletion in the accounting standards as part of the consequential amendments. We disagree with this and suggest that 'accounting' is included along with knowledge of the business and economic activities as part of the understanding that users should be expected to have. IFRS is part of the language of accounting and, without users being expected to having such an understanding, it will be difficult to ensure that disclosures, such as accounting policies, are focussed on key assumptions and judgements.

THE REPORTING ENTITY

We do not agree that consolidated financial statements are more likely to provide useful information than unconsolidated financial statements since this depends on the purpose for which they are used. Unconsolidated financial statements provide useful information about distributable profits and are useful in assessing the credit risk of the individual entity.

LIABILITIES DEFINITION

We agree that the revised definition of liabilities will need to be tested against a wide variety of situations to see how it will result in a different outcome to existing practice and whether this is an improvement. Perhaps because the concepts are unfamiliar, it is unclear what boundaries would be established in practice to determine whether the obligation has arisen from past events and whether the entity has no practical ability to avoid the transfer. For example, how much business disruption is significant and how more adverse must the economic consequences be before a transfer cannot be avoided?

While the revised formulation may result in a levy that accumulates over time but is payable only if a further condition is met being recognised as a liability arising over time, it is unclear how this would apply in other situations, particularly where the past event giving rise to the liability is unclear or uncertain. For example, if a levy was only payable based operating in a market at the balance sheet date, it is not clear that the revised definition would result in a liability arising at the balance sheet date for the year in question or whether it would result in a liability arising when the legislation comes into force for as long a period as it would take to cease operating in the market, which may be more than one year. It depends on how the concept of past events is applied, which may be difficult when it is unclear whether the past event has occurred or where the conducted activities, such as the failure to meet a regulation or comply with a law, occurred in the past and the extent of the obligation can only be established in a court of law. While there is no proposal to amend IAS 37 at this time, the examples in the standard should be tested against the revised definition to gain more understanding of how it could be applied.

We also note that the reference to adverse economic consequences may have consequences for constructive obligations. The change in emphasis from raising valid expectations on the part of others that the entity will honour its commitment, to whether or not the entity will suffer economic consequences that are more adverse if it does not meet its obligation, results in consideration only of the economic consequences for the entity. This may be appropriate, but the nuance of the entity being expected to perform by others, as well as considerations of non-economic consequences such as reputational damage might be lost, and therefore, some constructive obligations that are currently recognized would not meet the definition of liabilities and would not be recognized. For example, it is not clear that there are economic consequences for not reinstating environmental damage in the absence of a legal requirement.

In addition, if economic compulsion can be considered to result in a liability (if the entity has received past economic benefits), and if this is applied to debt/equity classifications it is likely to change the analysis to include considerations of different possible economic scenarios to determine which are potentially more adverse than others and therefore whether or not a liability exists. Whether such an approach would better meet the objectives of financial reporting will no doubt be considered in the debt/equity project.

Derecognition

The derecognition section states that derecognition normally occurs when the entity loses control of the recognised asset. The current requirements for financial assets are more complex since whether the entity has transferred substantially all the risks and reward of ownership is considered before the transfer of control. We believe this remains appropriate. It may be helpful to introduce the notion of substance over form in considering derecognition. This concept can be important to ensure, for example, that transactions that are in substance secured lending are treated in the most meaningful way.

MEASUREMENT BASIS

We consider the section does not address when to use a particular measurement basis so it would appear to be unbiased as to whether and in which circumstances, historical cost or current values are preferable. It may prove too general to be of use in setting standards. The section could be improved by a discussion that the relevance of the selected measurement basis to performance reporting is enhanced by its linkage to how cash flows are generated by the business activities. This does not mean that there should be a general discussion on the role of the business model in financial reporting or that the notion of long-term investment should be separately addressed, but that the framework should link selection of measurement basis with the business activities being depicted with the aim of providing information that is predictive of future cash flows.

INFORMATION ABOUT FINANCIAL PERFORMANCE

We note that equity is defined as the residual, the difference between assets and liabilities. However where OCI is used to record the difference in measurement between profit or loss and the balance sheet, amounts end up in equity which are essentially deferred gains or losses and not residual. It may be helpful to consider how the use of OCI impacts equity as the debt/equity project progresses.

We note that the CF includes a presumption that items in OCI will be recycled to profit or loss at a future date and as a result, we expect the IASB to consider whether this presumption should be applied to existing standards. In particular, IFRS 9 prohibits recycling of gains and losses on the disposal of FVOCI equity securities and for fair value movements relating to own credit risk and whether or not the presumption should be rebutted should be considered as part of the post implementation review of the standard.

AMENDMENTS TO STANDARDS

We question whether it is reasonable to expect entities to review and change their accounting policies as a result of changes to the CF, particularly where the IASB does not propose to make changes to existing accounting standards where these may be inconsistent with the CF. For example, where an entity has followed the hierarchy in IAS 8 and has determined an accounting policy by analogy to requirements in an IFRS dealing with a similar issue and that IFRS could now be inconsistent with the CF but is not being amended by the IASB, it seems unreasonable to expect the entity to develop a revised accounting policy at a lower level in the hierarchy.

We hope you will find our input useful and remain at your disposal if you have any questions or you would wish to discuss our views in more details.

Yours sincerely,

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