

Rådet *för* **finansiell rapportering**

The Swedish Financial Reporting Board

RFR-rs 2015:09

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

Dear Board Members,

Re: IASB Exposure Draft ED/2015/3 Conceptual Framework for Financial Reporting

The Swedish Financial Reporting Board is responding to your invitation to comment on the Exposure Draft on the review of the conceptual framework.

Our main points are that a framework must not hinder individual standards to reflect the rapid development of business and finance practices, that cost is a preferable measurement basis for most non-traded assets and liabilities and that, in these cases also reporting fair value information is in many situations not justified from a cost-benefit point of view. These points are elaborated below related to the following issues:

- The role of the conceptual framework
- Objectives of financial reporting and qualitative characteristics of useful financial information
- The choice of measurement methods
- Reporting some value changes as other comprehensive income and recycling
- Disclosure
- Business model
- Reporting entity
- Recognition
- Valuation of internally constructed assets

Role of conceptual framework

We believe that the primary role of a conceptual framework is to guide the standard-setter. However, we think that it should be possible for individual standards to deviate from the framework. There is a rapid development of business and finance practices and this should be reflected in financial reporting requirements. This could be achieved through amendments of individual standards. A framework should be stable and not change very often. Consequently, for a period of time, individual standards could deviate from the framework. However, any deviation from the framework in a new or amended standard should be clearly identified and the reason given. In the long run, the framework should be adapted to the new circumstances or the individual standards amended in line with the framework.

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Given that we accept such deviations, we think that the framework's role of guiding the standard-setter is more important than the role of disciplining them, since the latter would imply a more rigid view not accepting any deviations.

We agree with the approach to build on the existing framework instead of fundamentally reconsidering all aspects of the framework. We appreciate that the exposure draft is more distinct, leaving many of the deliberations to individual standards, and that the opinion of the IASB is that they will not automatically change existing standards as a result of the changes to the conceptual framework. If an existing standard works well in practice the IASB will not propose an amendment simply because of an inconsistency with the revised conceptual framework.

Objectives of financial reporting and qualitative characteristics of useful financial information

In chapter 1 of the existing conceptual framework, it's established that existing and potential investors, lenders and other creditors are the primary users of financial reporting. Their expectations about returns is said to depend on their assessment of the amount, timing and uncertainty of the future cash flows to the entity. Furthermore, it is stated that to assess an entity's future cash flows they need information on how efficiently and effectively the entity's management and governing board have discharged their responsibilities. Thus it is acknowledged that assessing stewardship is important, but only indirectly as a part of capital providers' other assessments. The ED gives more prominence to the objective of assessing stewardship, but does not identify the provision of information to help assess management's stewardship as an additional objective of financial reporting. We believe that stewardship is a fundamental objective of financial reporting and should be seen as equally important as outside capital providers' assessment of future cash flows. Furthermore, a basic premise seems to be that information that is relevant for capital providers is always relevant for stewardship purposes. This is not necessarily the case. There might be a conflict in this respect, and then it shouldn't be assumed that the information deemed most relevant to capital providers should be given priority. In such a situation, the question should also be asked why an alternative accounting method, e.g. another measurement method which is generally considered more relevant by a board of directors for stewardship purposes, or for management control purposes in a large, multinational entity, would not also be relevant for capital providers.

The ED reintroduces an explicit reference to the notion of prudence. We do not believe that prudence should be a qualitative characteristic, and are concerned that the reference to prudence in 2.18 might be seen as a reintroduction of prudence in its previously accepted meaning. If the other qualitative characteristics are met, this would result in appropriate financial reporting. Prudence could then be applied by other parties, such as investors or bank and insurance regulators. We recognize that there are incentives to give an (over-) optimistic view of an entity, that management and inside owners have an informational advantage over outsiders and that accounting has traditionally been a balancing factor, but do not see any way to apply a cautious approach in any consistent way. On the contrary, a cautious approach to asset and liability recognition in a specific period might result in an overstatement of profit in a future period.

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The ED does not include any reference to reliability as either an additional qualitative characteristic or an aspect of either relevance or faithful representation. We think that the concepts of relevance and reliability in the framework from 1989 are broadly established. Although there might be different opinions of the finer nuances of their meanings, we do not think that there are any alternative concepts for which a greater consensus would be reached and, more importantly, which would be of more assistance when developing individual standards. Furthermore, we believe that although relevance is of utmost importance, in many cases there is a trade-off between relevance and reliability i.e. between what a user would like to know and the quality of the information available. It is vital that this trade-off is made clear in the framework, and in our opinion the treatment of measurement uncertainty as an aspect of relevance does not emphasize the trade-off enough.

The choice of measurement methods

We believe that it is neither possible nor desirable to have one single measurement method for all assets and liabilities. We strongly support the view in the ED, that the purpose of assets and liabilities, and the way they are managed, should govern the choice of measurement method. In this context the business model concept might be useful (see specific comment on business model below).

The decisions related to measurement method, the distinction between profit or loss and other comprehensive income and recycling could be seen as a series of interrelated decisions. The first decision is to choose a measurement method, e.g. making a choice between a cost-based method and a current value. If a current value, such as fair value, is chosen, a second decision has to be made, whether the change in current value during the reporting period should be reported in profit or loss or in other comprehensive income. If the change in current value is reported in other comprehensive income, then a third decision has to be made, whether the amount reported in other comprehensive income at some later time should be recycled, i.e. affect profit or loss. We believe that the important question is the first one, the choice of measurement method, and that the most thorough analysis should be devoted to that issue.

Our experience is that in most cases a cost-based method is preferable. However, if there are arguments for a current measurement basis, the next step is to evaluate whether the change in current value during the period should be reported in profit or loss. If there are persuasive arguments against reporting a change in current value during the period in profit or loss, we think this is an indication that a cost-based method might still be preferable and that the choice of a current measurement basis should be reconsidered. We do not think that it is justified to report a current value in the statement of financial position and reporting the change in value outside profit or loss, just because that would give information about both cost and fair value. There are costs associated with reporting double measures and also a potential downside in terms of user confusion. Likewise, if there are persuasive arguments against recycling an item of other comprehensive income, one must ask whether it really is justified to dismiss a cost-based measurement method to begin with.

Reporting some value changes as other comprehensive income and recycling

We believe that when the relevance of different measurement methods is established, both the effects on the statement of financial position and on the statement of income have to be considered. As remarked above on the measurement issue, we believe that the choice of measurement method is the primary question and that arguments against reporting a change in current value during the period in profit or loss or against recycling an item of other comprehensive income are indications that a cost-based method might be preferable. However, we still believe that for some issues the fair value of assets and liabilities will be the most relevant measure, and should be reported in the statement of financial position, while the change in that fair value during a period might not be the most relevant measure of performance, and should not be reported as profit or loss. In these cases, reporting the change as other comprehensive income is a pragmatic solution.

We support the views in the ED, that profit or loss should be reported as a total or a subtotal, that the default alternative is to report value changes in profit or loss, but that at least some items should be permitted or required to be reported as other comprehensive income. However, we think that all items reported as other comprehensive income should be recycled. This would contribute to total profit equaling total cash flow in the long run, something we believe is important to strengthen the position of accrual accounting in general and profit or loss as a summary measurement of performance.

Presentation and Disclosure

We think that disclosure objectives cannot be established independently from other considerations in the framework. If, e.g. information about a right or a claim is relevant, the right/claim should be recognized as an asset/liability. If there is not sufficient reason for recognition, then information about a transaction or an event should not automatically be presumed, that should be decided in individual standards. Inadequate measurement could never be balanced by increased disclosure. Measurement must have a robustness that requires only a reasonable volume of disclosure.

As stated above we believe that in general the primary role of a conceptual framework is to guide the standard-setter. Considering the current situation we think that regarding disclosures the role to discipline the standard-setter is equally important. General statements are of limited value, thus the standard-setter should aim to develop disclosure objectives related to specific areas, such as accounting methods, key measurement inputs, alternative measurements etc., that will facilitate the formulation of well-defined and sufficiently precise requirements in individual standards. We believe that in the absence of well-defined and sufficiently precise requirements, companies, perhaps with the exception of the largest ones, will ask for additional guidance, resulting in a failure to improve on the situation today, when often too much data is disclosed. Another advantage of having well-defined and sufficiently precise requirements is that it will be possible to make a reasonable assessment that the requirements indeed have been satisfied, minimizing the need for companies to

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second-guess what, with the benefit of hindsight, might be challenged sometime in the future. We believe that the assessment of what is relevant information should start from information currently provided in the annual report, not by defining from “scratch” what is relevant information.

We agree with the treatment of materiality in the ED. Standard setters design standards for many different kinds of operations and transactions. It is in the nature of this that all requirements will not apply to an individual entity. It is the entity, which has to consider materiality. This fundamental principle should be established once and for all in the framework and then not be repeated.

Business activities including long-term investment

In our view the business model concept is important when considering the usefulness of financial reporting. In our opinion this is inherent in the suggestion in the ED that the way in which an asset or a liability contributes to future cash flow is considered in selecting a measurement basis and the need, in some cases, for more than one measurement basis. Our reasoning above about the importance of the objective of assessing stewardship enforces our view that the business model concept is important, and that this is not limited to long-term investment, which is just one of many possible applications. Having said that, we agree with the decision not to use the concept explicitly in the ED, primarily due to the difficulty in making a robust definition that would contribute further to the development of individual standards.

The reporting entity

An entity can, and usually does, prepare both individual and consolidated financial statements. We share the view in the ED that for some users' decisions individual financial statements will be more useful, and that these then complement the consolidated financial statements.

We think that the wording of 3.9 should be reconsidered not to give the impression that what in accounting theory is referred to as the entity view of financial statements, as opposed to the proprietary view, is the preferred approach. In our opinion the distinction between the entity view and proprietary view of financial statements is not very useful for the choice of accounting methods in individual standards.

Recognition

We share the view in the ED that it is not possible to define precisely when recognition will provide useful information and that in some cases an asset or a liability can exist even if there is a low probability that there will be an inflow or an outflow. In current practice two alternatives to deal with the probability of an outcome could be identified: (1) when an outcome is probable, i.e. more likely than not, the most likely amount is reported and (2) the expected value, i.e. the probability-weighted average of the amounts given different outcomes is reported. We believe that both alternatives have merit and that it is the individual circumstances that should govern the choice between

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them, considering factors such as whether there is a large number of similar objects, e.g. product warranties, or a single object, e.g. a provision for costs related to a lawsuit, and the measurement uncertainty related to both the probability of different outcomes and to the amounts associated with each outcome. When both the probability and the amount could be measured reliably, then an asset or a liability could be recognized, even if the outcome is not probable (not more likely than not). We think that measurement reliability should be assessed in relation to different kinds of assets and liabilities, since we expect the result to be different, e.g. will the measurement reliability criterion be fulfilled more often for financial instruments than for operating liabilities. We believe that this should be stated in the framework to provide guidance to the standard-setter addressing the issue in individual standards.

Regarding fully executory contracts, we are of the opinion that at the inception of a contract rights and obligations have equal value and consequently should not be recognized in the financial statements.

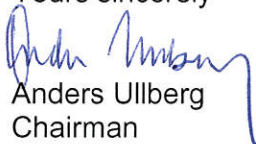
A brief remark on valuation of internally constructed assets

In 6.73 it is stated that measuring an internally constructed asset at fair value at completion could provide relevant information, although the cost of doing so may outweigh the benefits in many cases. In our opinion this would be just one example of a case when both relevance and reliability have to be considered and we see no reason why this specific case should be mentioned in the framework.

If you have any questions concerning our comments please address our Executive member Claes Janzon by e-mail to: claes.janzon@radetforfinansiellrapportering.se.

Stockholm, 21 October 2015

Yours sincerely



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Chairman