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Banking supervision
And Accounting issues Unit
The Director

Paris, November 24th 2015

FBF Comments on the Exposure-Draft: Conceptual Framework for Financial Reporting.

Dear Mr Hoogervorst,

The FBF welcomes the opportunity to comment on the IASB Exposure Draft 2015/3 Conceptual Framework for Financial Reporting.

As mentioned in our previous comment letters, we support the comprehensive revision of the Conceptual Framework undertaken by the IASB. In our view, the Conceptual Framework is the primary conceptual source for the IASB to develop and improve the Standards based on consistent concepts and for stakeholders (i.e. preparers, auditors and users) to understand and apply IFRS.

We welcome that consideration has been given to the objective and qualitative characteristics of financial reporting, notably the reintroduction of prudence and the emphasis put on stewardship. Regarding prudence, whilst we are in line with the Basis for Conclusion developments, we do not share the concluding remarks as we believe that in some circumstances the asymmetric prudence should be considered when setting standards. Therefore, a standard setter should not be prohibited in some circumstances to introduce asymmetric prudence in a standard in order to provide useful financial information. We also welcome that the ED recognizes that the statement of profit or loss is the primary source of information about financial performance of the entity.

We acknowledge that the IASB aims to conduct the revision of the Conceptual Framework on a timely manner. However, we are concerned that some aspects should have been considered in greater depth. In particular, the existing definition of assets and liabilities should be retained until the consequences of the revised definitions have been properly assessed.

Mr Hans HOOGERVORST
Chairman
International Accounting
Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

18 rue La Fayette 75440 Paris cedex 09 – Tel : 01 48 00 52 52 – Fax : 01 42 46 76 40
Internet : www.fbf.fr

We also believe that the issues regarding the definition and the use of OCI have not been adequately addressed, notably in conjunction with the concept of financial performance that should adequately picture the business activities and the way they are managed. We regret that the notion of performance has not been further developed and no guidelines have been provided.

We support a broadened scope of users of financial information that includes entity's management rather than being limited to any particular group of users. Finally, we would have expected that the ED would have put emphasis on the role of business activities in selecting the measurement basis. Business activities should be the primary factor in selecting the measurement basis.

Our detailed comments on specific issues raised in the exposure draft are detailed in the following annex.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,

Bertrand Lussigny

Annex:

Chapters 1 and 2: The objective of general purpose financial reporting and the qualitative characteristics of useful financial information.

Prudence

We support the reintroduction of the notion of 'prudence' in the CF as a qualitative characteristic of financial information. Prudence is described as "the exercise of caution when making judgements under conditions of uncertainty". Indeed, caution is needed in making estimates and judgements in order to enhance relevance of financial information and faithful representation of business activities.

Nevertheless, it should be explained that prudence should not encompass over conservatism which may serve other purposes, such as prudential purposes. It differs from regulatory prudential concepts in the context of the calculation of banks' "own funds" and, for example, their estimates of expected losses and calculation of risk weighted assets.

Prudence is introduced in relation with the concept of neutrality, to ensure that preparers, when making estimates under conditions of uncertainty for financial statements avoid any bias in their judgment in the exercise of measurement. The introduction of the concept of prudence should also ensure that losses and liabilities are recognised in a timely manner and that gains are accounted for when evidenced and thus could affect not only measurement but also recognition.

We think that asymmetric prudence is not applied in standard setting in a manner that would contradict the neutrality of information or in a manner that would not be satisfactory from a user point of view. This is reflected for example in IAS 37 where contingents assets are not recognised when their realisation is not certain and where liabilities are recognised when their outflows are probable. We think that IAS 37 principles are appropriate in terms of recognition threshold for assets and liabilities. Therefore, a standard setter should not be prohibited in some circumstances to introduce asymmetric prudence in a standard if it results in relevant information that faithfully represents what it supposed to represent.

In the Basis of Conclusions, the IASB acknowledges that treating gains and losses asymmetrically could be useful for providing relevant information and that such an approach is reflected in many existing standards (BC2.14). However we believe that the IASB quickly concluded in BC 2.15 when it rejected asymmetric prudence as a characteristic of useful financial information. It should be stated in the CF that in some circumstances the asymmetric prudence should be considered when setting standards for both recognition of assets and liabilities and their subsequent measurements.

Stewardship

We welcome the introduction of the notion of stewardship in the CF as stewardship is an important element of the general purpose of financial information. However we disagree with the IASB that considers stewardship a sub-element of the objective of financial reporting. We believe that, stewardship should be an objective of financial reporting as such. The information that is useful must be then defined as a necessary information at the same time for the assessment of the management's stewardship and for the decisions of the investors.

The ED considers stewardship as solely part of useful information to investors when making their decision of buying or selling or holding equity and debt instruments. We believe that the notion should not be limited to the utility of the information for the short term and long term investment decisions of investors. It should be considered that stewardship is useful to reflect accountability of the management when they fulfil their missions of management of the entity's resources and obligations and to assess the strategic decisions that management has taken to create value in the long term.

Investors and management need to share the same indicators of financial information when assessing performance of the entity. Management needs to portray the economic reality when preparing financial reporting, i.e. to ensure continuity between the information published externally and the information needed internally.

Therefore, we believe that the entity's management should be considered as users of financial information in the same way as investors and creditors. Indeed, as financial information is a mean of communication between investors and management, it is important for the management to prepare the financial statements from the perspective of the entity, and that financial position and performance properly depict the way the management uses and allocates the resources. For instance, as highlighted during the discussions on the DP on the Dynamic Risk Management, opposing this approach could result in the equity book model being excluded from an accounting solution for dynamic risk management because of the assumed inconsistency with the conceptual framework (impossibility to hedge equity) to the detriment of a faithful representation and relevant information on dynamic risk management. Thus, the Conceptual Framework should not prevent from hedging the equity book as this is the way entities manage risk dynamically.

Chapter 5: Elements of financial statements

Definition of equity.

The ED did not change the existing definition of equity as the residual interest in the assets of the entity after deducting all its liabilities.
Yet, given that the definition of liabilities and the definition of equity are closely interlinked, we believe that the IASB should not have prematurely modified the definition of liabilities without considering more broadly the consequences of such changes within the Financial Instruments with Characteristics of Equity' research project.

Definition of assets

The ED defines an asset as "a present economic resource controlled by the entity as a result of past events". The term "economic resource" focuses on rights that have the potential to produce economic benefits. The notion of expected inflow of resources of the current definition has been removed.

We believe that further analysis should have been conducted to determine what the consequences of the removal of assessment of uncertainty would be with regard to recognition of assets. We wonder what would be the impact on business combination recognition and whether the proposed definitions may lead to the recognition of economic resources which are currently considered part of internally generated goodwill which are not recognised under current IFRS and may impact business combination accounting.

Definition of liability.

As the outcome of the research project related to liabilities and equity instruments may impact the revised definition of liabilities proposed in the ED, we believe that the existing definition of liabilities should not have been changed.

When defining a liability, the ED focuses on the present obligation of the entity at the reporting date resulting from past events and does not retain the probability criterion. We question such removal as it would lead management to consider and to define all possible scenarios and occurrence of possible outcomes. Tracking and processing information to measure improbable future outflows with low probability of occurrence would generate costs that would not be offset by additional benefits. Besides, the ED explicitly introduces the notion of constructive obligation (cf. CF §4.34) that already exists in the IAS 37 definition of an obligating event / present obligation and thus in IAS 37 definition of a liability.

Moreover, we wonder what would be the impacts of the proposed definition in combination with recognition criteria when recognizing liabilities and whether or not it would broaden unintentionally obligations to be recognised without necessarily providing more relevant information. Indeed, one of the criteria of recognition is the probability that any future economic benefit related to the liability will flow from the entity. The ED (§5.17 – 5.19) states that a low probability of outflow of economic benefits does not prevent from recognising liabilities as it may provide relevant information.

Furthermore, the ED states that a present obligation exists when the entity has no practical ability to avoid the transfer of an economic resource through its future actions and that the obligation has arisen from past events. However it is unclear where to set a threshold between the two criteria "no practical ability" and "past event".

For these reasons, we question how the proposed definition will address the concern raised by IFRIC 21 and how it could be applied to the recognition of levies. The IASB should have carried out a proper assessment in order to understand the possible unintended consequences of the proposed definition, before proposing such modifications in the definitions.

Besides, the proposed definition of liabilities should not contradict IFRIC 2 regarding conditions of classifying financial instruments as liabilities or equity to co-operatives and similar entities. We have concerns about unexpected consequences of this change on the current classification.

Chapter 6: Measurement

We support the ED proposals to distinguish different measurement bases for financial information (historical cost and current value). In some cases, more than one measurement basis could be needed in order to provide relevant information in the statement of financial position, on one hand, and in the statement of profit or loss on the other hand.

The ED considers different factors when selecting a measurement basis and states that the relative importance of each factors will depend upon facts and circumstances. However, the ED does not specify how these factors would interact and how much priority should be given to these factors.

Two factors are considered in the ED when selecting a measurement basis for an asset or liability and the related income and expense (§6.54). The two factors are those retained by IFRS 9 i.e. the business model and the characteristics of the financial instrument.

We would have expected that the ED had put emphasis on the role of the business activities in selecting the measurement basis and had confirmed their prominence as primary factor of measurement prior to the characteristics of the financial instrument.

Indeed, the business activities are a critical criterion for choosing relevant measurement attributes because it is informative on the way the entity operates its business and adds value. It is a matter of fact that reflects the way the entity is managed to generate future cash flows and returns from its assets and liabilities. It is particular relevant to the choice of measurement basis in order to provide users a faithful representation of the performance of the entity's activities. A focus put on the characteristics of the instrument may lead to question whether financial information is truly representative of the entity's business activities and question whether useful information is provided to users, as evidenced by the application of IFRS 9. Thus, we strongly believe that business activities should be the primary factor when selecting the measurement method to be applied to assets and liabilities and it should not be overridden by the characteristics of the instrument.

Chapter 7: Presentation and Disclosure

Presentation in the statement of comprehensive income—profit or loss and other comprehensive income - Recycling

We agree with the objective of financial statements as stated in the ED and with the scope of financial statements. We welcome that the ED recognizes that the statement of profit or loss is the primary source of information about financial performance of the entity.

The ED refers to the principle of relevance of the information when defining items to be reported in the statement of profit and loss or in the statement of OCI and when deciding which items of income or expenses reported in other comprehensive income in one period should be recycled in a future period. However, the ED does neither provide a definition of performance nor develop concepts for deciding which items must be reported in P&L or which items must be reported in OCI. We would have expected that the CF would address what is the role of the profit or loss and the OCI and when recycling.

However, the ED presents two situations where the presumption of recycling cannot be rebutted (cf. CF §7.23) and a general approach referring to relevance in order to define under which circumstances the presumptions would no longer be valid (cf. CF §7.24). We believe that the rebuttable presumption and the reference to relevance are conceptually insufficient. The necessary principles and guidance should be set at the conceptual framework to define financial performance or criteria required to present items of income and expense in OCI. Therefore, we would encourage the IASB to work towards a definition of performance and therefore defining which items are recorded in profit or loss and which items are recorded in OCI.

Items initially reported in OCI should be recycled where reasons for initial recognition in OCI no longer apply or when items recorded in OCI are realised in cash or equivalent. We agree with BC7.54 that states that "no income and expense should be excluded from the statement of profit or loss permanently, unless there is a compelling reason to do so." Accordingly, recycling should be mandatory to reflect in the statement of profit or loss management decisions at some point in time and to make the statement of profit or loss relevant to illustrate the performance of the entity.

For these reasons, we see no rationale to have different recycling principles for recycling debt and equity instruments measured at FVOCI in IFRS 9.

Other issues

Business activities.

The ED introduces consideration of the nature of the entity's business activities in the CF.. We agree with the view that financial statements would be more relevant if standards reflect how an entity conducts its businesses (BCIN.28) and how an entity will realise its future cash flows and returns. Accordingly, business model should play a role in all aspects of financial reporting, i.e. measurement, unit of account, presentation and disclosure. We welcome the introduction of the concept of "business activities" in the CF as long as it is in line with the term of "business model" as referred to in IFRS 9.

As explained in our comments on Chapter 6, we believe that when defining the primary factor to select a measurement basis, it should be considered how measurement could reflect the way the assets and liabilities are managed and used by the entity, how these assets and liabilities contribute to future cash flows and how performance related to these assets and liabilities is assessed. Therefore, we believe that the business model should be the primary factor when selecting a measurement basis

Long term investments

Financial statements and notably financial performance should reflect the business activities of the entities. Thus, as long as the performance for long term investments is correctly reflected as with any other business activities, there is no need to distinguish long term investments from other investments.