JOINT OUTREACH EVENT

IASB DISCUSSION PAPER

A REVIEW OF THE CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

AMSTERDAM

30 OCTOBER 2013

This feedback statement has been prepared for the convenience of European constituents by the EFRAG secretariat and has not been subject to review or discussion by the EFRAG Technical Expert Group. It has been reviewed by IASB staff and has been jointly approved for publication by representatives of EFRAG and the DASB who attended the joint outreach event.

Joint Outreach Event

This feedback statement has been prepared for the convenience of European constituents to summarise a joint outreach event held by EFRAG and the Dutch Accounting Standards Board (DASB), in cooperation with the IASB, on 30 October 2013.

The joint outreach event was chaired by Hans de Munnik, Chairman of the DASB.

The joint outreach event was one of a series organised across Europe following the publication of the IASB Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*. The purpose of the outreach event was to:

- stimulate the debate on the Conceptual Framework in Europe;
- obtain input from constituents, in particular from those that may not intend to submit a comment letter to the DASB, EFRAG or the IASB, and to understand their main concerns and wishes;
- receive input for the DASB's comment letter to EFRAG and the IASB; and
- learn whether the preliminary comments as set out in EFRAG's draft comment letter were shared by European constituents.

Peter Clark (IASB Director of Research) presented the Discussion Paper on selected issues and Rasmus Sommer (EFRAG Senior Technical Manager) and Hans Schoen (EFRAG Acting Director of Research) summarised EFRAG's preliminary positions. An open debate then took place with participants.

The participants had different backgrounds such as user, preparer, auditor, regulator and academic.

Issues covered

Participants discussed definitions, recognition/derecognition, measurement profit or loss and other comprehensive income, equity versus liabilities and other issues

Participants discussed the following issues:

- Definitions of assets, liabilities and equity;
- Recognition, derecognition
- Measurement;
- The use of profit or loss and other comprehensive income;

- Equity and liabilities; and
- Other issues.

Comments received

Definitions of assets, liabilities and equity

IASB staff did not expect changes in the definition of elements to result in more assets and liabilities

The Discussion Paper proposes some changes to how an asset and a liability are defined. A participant asked whether the suggested changes would result in more assets and liabilities than currently. The IASB Director of Research replied that the suggested changes would bring the wording more clearly in line with how the IASB had tended to apply the existing definitions. The purpose of the changes was not to cause a significant shift in how the IASB applied the definitions.

The IASB considered cash on hand and goodwill to be assets

A participant asked whether cash on hand and goodwill would meet the definition of an asset. The IASB Director of Research answered that cash on hand would meet the definition as it could be used to buy other assets. The IASB had concluded in developing IFRS 3 *Business Combinations* that goodwill met the definition of an asset, but not all constituents agreed with that assessment.

A participant did not think that the service margin of an insurance contract would meet the definition of a liability. The IASB Director of Research believed that the service margin on its own would not meet the definition of a liability. However, the service margin should not be considered separately, it was part of the overall liability. An insurance contract was more than an obligation to pay cash. It also included providing services.

Not only unconditional obligations should be considered to be liabilities

Different views on whether a liability for one party should be matched by an asset for another party

The Discussion Paper questions whether only unconditional obligations should be considered liabilities. A participant agreed with the view expressed in EFRAG's draft comment letter that also some conditional obligations should be considered liabilities. However, the participant noted that this would in some cases result in liabilities being recognised earlier than under current practice. It should therefore also be considered to recognise assets earlier. Another participant thought that a liability for one should be matched by an asset for another. A third participant, however, disagreed and thought that in some cases it could be relevant to recognise the liability but not the asset. This participant did not think this would conflict with the principle of neutrality as the financial statements should only depict relevant information.

A fourth participant thought that definitions of assets and liabilities should be sufficiently flexible to allow for future contractual setups (e.g. rate regulated activity) to be accounted for in a manner that would result in relevant information.

Recognition and derecognition

It was unclear what EFRAG meant by an 'outcome risk'

EFRAG's draft comment letter noted that EFRAG TEG was undecided on whether the Conceptual Framework should include probability thresholds related to recognition. Some EFRAG TEG members thought it should, but noted at the same time that items where the main component represented an outcome risk should always be recognised. Several participants were uncertain about what EFRAG meant by an outcome risk.

The Conceptual Framework should not include probability thresholds for recognition

One participant did not support retaining probability thresholds. Instead uncertainty should be reflected in measurement. In some cases an entity could have an obligation to accept returned goods for 100 years, but practical solutions could be introduced to release these entities from recognising an obligation for the entire period.

Another participant thought that probability thresholds should not be included in the Conceptual Framework, as the Conceptual Framework should only deal with more general issues. Accordingly, in the Conceptual Framework relevance and reliability were the appropriate thresholds. Probability thresholds could be introduced in Standards. However, as the thresholds could be different in different Standards, and as it could sometimes be unclear what guidance to apply, the IASB would have to clarify the hierarchy by which Standards should be considered. It might also be necessary to prepare a fall back Standard including recognition thresholds that would capture transactions and events not covered by other Standards.

A third participant was against retaining probability thresholds as recognition criteria should depend on how assets and liabilities were measured. For example, it did not seem meaningful to introduce recognition thresholds for financial derivatives measured at fair value.

Measurement

Management's judgement should be minimised

A participant thought that when choosing a measurement basis an objective should be to reduce management's use of judgement. According to the participant management's judgement introduced uncertainty for users of financial statements. EFRAG's draft comment letter proposed that the entity's business model should be considered when choosing measurement bases. However, uncertainty was introduced if it was difficult to determine the business model. The IASB Director of Research did not think the Discussion Paper set a specific objective of minimising judgement, but the issue could be considered in relation to verifiability.

Different views on whether and how the Conceptual Framework should link measurement with an entity's business model

Different views were presented in relation to how an entity's business model should affect measurement. One participant thought that it would be unfortunate if Standards would impede an entity from changing its business model when its environment changes. The IASB Director of Research noted that this was one of the reasons why the IASB had chosen not to refer to a specific notion of the entity's business model when considering measurement. The IASB representative thought that if measurement were to be explicitly linked with an entity's business model, the business model would need to be defined precisely, and this could be very difficult and might prove too limiting.

The EFRAG Acting Director of Research thought that an entity's business model should be defined. He thought that an entity's business model was quite stable and something different from management intent. In addition, if an entity had an inferior business model, he thought that something was wrong if financial statements did not reflect that fact.

With the exception of financial institutions, a participant thought that an entity's business model was very stable. Standards should therefore not include restrictions related to depicting an entity's business model in order to prevent abuse.

A participant did not think the Conceptual Framework should include much on the business model. In relation to some issues, it seemed to be given. For example, inventories were always held for sale. Too much focus on the business model could end with too many options in the Standards.

Sometimes it would be relevant to reflect opportunity costs

EFRAG's draft comment letter argued against presentation of opportunity costs. A participant thought, however, that IFRS 2 *Share-based Payment* recognised opportunity costs and the participant was in favour of that if it would better reflect performance. The participant considered these opportunity costs to arise because the entity is obliged to issue shares for free (instead of selling them).

The EFRAG Acting Director of Research noted that EFRAG was not against recognising opportunity costs in all cases.

The use of profit or loss and other comprehensive income

Instead of trying to find the attributes to be used when distinguishing between items reported in other comprehensive income and profit or loss, it should be considered what information would be useful

A participant noted that when the IASB had developed the Discussion Paper, it had tried to consider whether the distinction between items reported in other comprehensive income and items reported in profit or loss could be based on particular attributes. These attributes included whether something was realised or unrealised, recurring or non-recurring, or operating or non-operating. The participant thought that the IASB, instead of considering whether these attributes could be used to distinguish between items reported in other comprehensive income or profit or loss, should have considered whether providing information about these attributes would result in useful information. If it would, then it could be considered whether presentation in separate statements or in different parts of the statement of comprehensive income would best present this information.

The IASB Director of Research considered that the question of what lines and subtotals should be presented could be dealt with in IAS 1. It was recycling that caused the need for the Conceptual Framework to address the distinction between profit or loss and other comprehensive income.

A participant asked whether presentation in other comprehensive income or profit or loss would be something that each Standard had to deal with.

A variety of views were held on recycling

Income and expenses should not include all changes in assets and liabilities

A participant thought that other comprehensive income should only include items that would be recycled. Another participant, however, questioned whether it would ever be relevant to recycle. Recycling would mean that information about value changes would be presented in profit or loss long after the changes had taken place. The participant did not think this was relevant information and noted that the number of non-GAAP measures had increased over the past years. This was likely to be because the statement of profit or loss included many irrelevant figures and the introduction of other comprehensive income had not solved this problem.

A third participant thought the problem was that the definitions of income and expenses required all changes in assets and liabilities to be recognised.

The IASB Director of Research welcomed suggestions for better definitions. One way of distinguishing between items reported in profit or loss and items reported in other comprehensive income was to define separate types of income and expenses for both profit or loss and other comprehensive income. However, this approach would likely be difficult, particularly for items the

Discussion Paper termed transitory, because there was no tight definition of these items.

A discussion on performance reporting was needed

A participant thought that the IASB should reopen the discussion on how to reflect an entity’s performance. The frequent use of alternative measures was evidence of the IASB not being successful in this area. Even the IASB chairman had noted that nobody understood other comprehensive income.

The IASB Director of Research thought that it would be easier to understand other comprehensive income if it was explained what types of items were included in it.

A participant thought that if it was not considered in the Conceptual Framework what would be reported in other comprehensive income, it should at least be determined on a Standards level.

The IASB should decide whether the focus should be on the statement of profit or loss or on the statement of financial position

Another participant noted that, for example, obligations related to rate regulated activities would not meet the definition of liabilities, but many thought that it would not reflect performance if these liabilities were not recognised. The participant asked whether there should be bridging items for items that it would be relevant to include in comprehensive income but did not meet the definition of a liability. The participant thought the problem illustrated that it was important whether the starting point was the statement of financial position or the statement of profit or loss. Another participant noted that the best starting point would depend on whether the primary objective of financial statements was to assess an entity’s equity position at the balance sheet date, or to assess performance in the period. The participant thought that there was a move away from considering reflecting the financial position to be the primary purpose, but in order to progress it was necessary to decide what the primary objective should be.

Equity and liabilities

A participant thought that the Discussion Paper focused on control rather than risks and rewards. Accordingly, a party bearing the risks and rewards of an entity, but not controlling the entity, would not be considered as an equity holder.

The IASB Director of Research did not think that the IASB tried to draw the distinction between equity and liabilities based on who would be considered to be an owner of a reporting entity. In his view it would be difficult to categorise instruments based on whether they conveyed an ownership interest.

Information about dilution and how changes in equity affect assets and liabilities should be provided

The Discussion Paper proposed that wealth transfers between classes of equity claims should be presented. A participant thought this information was useful, but incomplete from an investor's point of view. Investors were not particularly interested in book equity but in dilution. Information about changes in book equity was therefore not particularly interesting. The interesting part was how these changes affected dilution. Information about dilution should therefore be required in addition to what was suggested in the Discussion Paper. Furthermore, as investors tried to model changes in assets and liabilities rather than the changes in equity, they would like to know the changes in net assets resulting from changes in book equity. For example, if the entity had issued new shares, investors wanted to know whether the resulting change in net assets was caused by a decrease in debt or an increase in cash.

The proposal to show wealth transfers between classes of equity holders was costly

Another participant considered it very complex and unnecessary to remeasure equity claims as suggested by the Discussion Paper. It was not uncommon that minority interests had put options based on multipliers on EBITDA and it was very difficult to measure these. Information about the potential dilution effect could be provided in a less costly manner by disclosures.

The IASB Director of Research noted that, under IFRS 2, a cash settled share option had to be remeasured, whereas this should not be done for equity settled share options. The proposal would result in the equity settled share options being remeasured as well, but through the statement of changes in equity and not through the comprehensive income.

Information reflecting a common equity holder perspective should be provided

A participant noted that investors wanted information from a common equity holder perspective. Investors did not buy the equity of an entity - they bought common equity. Accordingly, the Conceptual Framework should state that also information reflecting a common equity holder perspective should be provided in the financial statements.

Another participant was concerned about the fundamental rethink on equity versus liabilities that was presented in the Discussion Paper. The changes could have significant impact in different jurisdictions given the fact that there were different types of contracts and legal aspects in the different jurisdictions. The participant was particularly worried as the project had not been presented as a fundamental rethink. Another participant did not share this concern, but thought, however, that the proposal was overly complex. This participant suggested dilution should be illustrated in a manner similar to how diluted EPS was presented. A third participant noted that diluted EPS should only be presented by listed entities.

A participant thought it was necessary to acknowledge initially that there would not be any ideal solution. The participant thought that the Conceptual Framework should only deal with the issue on a high level and then include more details in a Standard on debt/equity. Finally, the participant favoured the proprietary perspective, as this was the view most economic decisions were taken from.

Other issues

The detailed Discussion Paper does not necessarily result in a detailed Conceptual Framework

The length of the Discussion Paper indicated that the Conceptual Framework would be very detailed, a participant thought. The participant thought that this was unfortunate as the Conceptual Framework should only provide general guidance and not replace more detailed Standards. The IASB Director of Research explained that many of the details included in the Discussion Paper would not end up in the Conceptual Framework.

Insufficient emphasis on performance reporting

The Discussion Paper did not place sufficient emphasise on performance reporting according to one of the participants. The IASB Director of Research explained that the IASB in the Discussion Paper had tried to emphasise that the statement of comprehensive income was as important as the statement of financial position.

Another participant thought that the Discussion Paper failed to explain the importance of the cash flow statement. The IASB Director of Research noted that the Discussion Paper referred to the statement of cash flows as a primary statement. The IASB had discussed whether the Conceptual Framework should include more definitions related to the statement of cash flows. However, many regarded the presentation of cash flows more like a disclosure requirement than a presentation of elements of financial statements. A participant questioned the usefulness of the information of cash flow statements of financial institutions.

The IASB could not deal with all aspects of integrated reporting

A participant asked why the IASB had narrowed the scope of the Conceptual Framework to financial reporting instead of considering integrated reporting. The IASB Director of Research replied that although the IASB was closely following the development in integrated reporting, it thought that its competences were limited to dealing with financial information.

Some participants were uncertain how changes to the Conceptual Framework would affect standard setting. The IASB Director of Research explained that possible projects to amend Standards would have to be assessed as part of the normal agenda consultation process. When developing the exposure draft to the review of the Conceptual Framework, it could be noted where the main conflicts would be between current Standards and the proposed Conceptual Framework. The IASB Director of Research said that it would be surprising if the revised Conceptual Framework resulted in major conflicts with newly issued Standards, such as the new standard on insurance contracts and IFRS 9, as these standards reflected IASB's most recent thinking.

Participants noted that the Conceptual Framework was not a Standard and so was not endorsed. The IASB Director of Research noted that he was not aware of any plans for the EU to endorse the Conceptual Framework.